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THE CLASSICAL ANALYSIS OF POLITICAL ECONOMY

... THE RECONSTRUCTION OF HENRY GEORGE

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As the Los Angeles High School "Interstudent" Program gathered strength, it became evident that the content of our teaching required important revision. The Progress and Poverty course was inadequate as a basis for an encompassing and satisfying philosophy. Its structure - a registration session followed by nine more of which three were devoted to land-value taxation - served mainly as a vehicle for land tax reform propoganda with any educational role underplayed or forgotten.

The deeper implications of the classical Political Economy of which George was so articulate a spokesman was lost to all but a few of the many thousands who completed our offerings: most graduates became - at best - land-value taxers or joined the neutral (or hostile) drop-outs lost along the way.

No-one can doubt the importance of Rent theory in the classical analysis and few object to using the Rent fund as a source for community revenue. However, the time spent on land-value tax discussion must be subtracted from the total available and this leaves little for other important aspects of the science. Thus, the label of "propaganda" is not undeserved by our courses in "Fundamental Economics."

This is not to deny the assertion that if we don't - then who will? Rather, it is to emphasize the nature of our courses as advocacy and instruction and therefore their unsuitability for philosophical education.

Yet, the need for philosophical understanding of Man and his relationships with his own kind and with his world is rampantly obvious in the student population. In spite of herculean effort by teachers, generations of social studies throughput has done little to reduce a mountainous ignorance of Man's behavior - a failure evident in the aftermath of every electoral contest. The educators had offered teachers the opportunity to chip away fragments of ignorance when the mountain could be levelled by the blasting powder of student understanding. But, the teaching of philosophical ideas requires consistency. Ideas that do not hang together will assuredly be hanged separately. An incoherent philosophy withers under attack: a coherent philosophy displays a cohesiveness that encourages not only understanding but confident excursion into unknown areas.

In preparation, the study known as "The Classical Analysis" required little addition to previous writings. What was needed was the extraction from the voluminous literature of Political Economy of that skeletal reasoning we call "science." Henry George - perhaps the last of the great "classical analysts" - achieved his renown, not from his great leaps forward but from his ability to press from the complexities their essence. He gave to a massive 19th century readership the potential for understanding by simplifying the ponderous, but the provision of an elegant and artistic solution to revealed problems overwhelmed the analysis and led to its burial beneath the popular campaign for the "Single Tax."

The "classical analysis" is an exposition of the reasoning found in the writings of 18th and 19th century political economists. The eloquently expounded critique of that reasoning found in George's published works provides a useful beginning to such a discourse. The "classical analysis" continues this critique; expands to include George's ideas; then amends in the direction of precision and clarity.

### The Nature of Man

All sciences begin with assumptions. The whole structure of classical political economy rests on that recognition of human nature described by the two Axioms: "Man's desires are unlimited" and "Man seeks to satisfy his desires with the least exertion."

Some comment on the latter is appropriate. "Desire" is not the same as "want," but implies intent to satisfy. The assumptions describe the outward manifestation of desire and not the desire itself. Political economy is not concerned with what is happening behind the forehead, but only with actions outwardly discernable. That two people may act the same way does not indicate that they desire the same thing. The contention of the Austrian School that all value is subjective is a startling statement of the obvious, for everything is subjective to us. Marginal utility theory may be similarly regarded. My second, third, or fourth television set may be progressively less desirable than my first, but the only datum available is that the four sets were valued by me at more than their price - and the fifth is not. Evidence is the act of exchange.

Certainly, our desires will form a pattern of priority in which the strength of the desire will be measured against the ease of its attainment, then reasonably placed in order of action - yet these inferences of a "hierarchy of value" stem from objective evidence (action that improves chances of survival).

The important word in the second assumption is "seek." There is no implication that Man exerts least, but that he looks for the least exertion. The market place is the arena where this is most easily seen. Failure to understand this point has led to the shaky discussion of "imperfect

competition" - as if market decisions must conform to some extra-market version of perfection. (Modern analysis includes legal monopoly as part of imperfect competition - a triumph of semantic obfuscation.)

Both assumptions are observations and are not the same as describing Man as "greedy" or "lazy" - which are value judgments. They are Natural Laws (recognitions of experience) which indicate that Man has purpose. Animals obey the "economy of effort" principle because those who do survive, but choice is not involved. Man may choose his direction. Much is made of the mighty redwoods, the cute Adelie penguins, the gorgeous condor and the devoted dog, but these are merely unreasoning living things. The adjectives are Man's and no credit can be given to a redwood for acting like a redwood, or to the others for obedience to an instinctual pattern. Their beauty, majesty and love exist only in the mind of Man. However, the survival of Man - who can short circuit instinct and choose his path - indicates an effective reasoning ability. Less effective reasoners are long gone in a world that at best is neutral.

One other point arises from the "least exertion" principle: that Man desires full unemployment. His ultimate objective is to satisfy all his desires for no exertion, but reason tells him that such a Nirvana is unlikely to occur. As say the libertarians "TANSTAAFL" - "There ain't no such thing as a free lunch."

This is the creature who is adjured to "limit his growth;" who must be provided with work; who blindly destroys himself and the world; who is "vile" among all those things bright and beautiful.

This necessary prelude to analysis is repeated, for these thoughts are often lost in the pell-mell dash for the land-value tax discussion. Understanding the subject of our study makes easy further inquiry: failure (or refusal!) to understand makes progress all but impossible. Much modern study of Man is rendered sterile by a formidable reluctance to treat his reality.

We can now make some statements that grow out of our understanding of the nature of Man:

- \* The path to anything is exertion and its cost is the corollary to exertion, fatigue (time and tedium will be dealt with later);
- \* Cheapness is directly related to progress;
- \* Expensive "labor" (human exertion) is best;
- \* Cooperation is sensible;
- \* Man is not naturally "warlike;"
- \* Food is more important than philosophy or freedom;
- \* Garbage men are more important than teachers;

- \* Man is more important than his environment;
- \* Man will choose justice because it makes sense.

### Concepts, Definitions and Names

At this time we must make some concept definitions and attach to them names. The procedure, which is sometimes forgotten, is to arrive at a concept; then to define it (put a boundary around it); then to name the result. For example, a group of free men discussing their conditions of cooperation would be likely to agree to equality. This consensus is likely to arrive from the desire of each to be "more equal" and the refusal of each to be "less equal" than the others. Cooperation with others is advantageous and its price is equality of condition. This is the concept. However, the argument may not produce perfect equality, for some may put their case badly or negotiate inartistically. Nevertheless, the approximate equality may be accepted even though the delineation is not so much a line as a no-man's-land. We can call this defined concept by the name of "Justice."

A similar procedure is followed with other concepts. When a group of people cooperate they accept a code of conduct. This might be the "just" code mentioned in the previous paragraph, or any other. The accepted code is their "morality." A headhunting tribe might stop the practice of taking each other's heads - either by agreement, or by change of custom. Now their bridge games are a little less tense, but the tribe down the way are pretty effective at taking heads so the agreement might expand to the other tribe. Their morality is changing and - we might argue - for the better. In fact, we can conceive not only a better morality, but a "best" morality. We can name this "ethic" and call the study of the best morality "Ethics."

Applying these two words to two concepts makes them useful. The practice of treating them synonymously is not conducive to clarity: also, it wastes a word. To illustrate the effectiveness of carefully defined concepts and their appropriate naming, we can trace the relationship of law and privilege.

We begin with Natural Law, which is a recording of experience - an observed natural regularity described in formal fashion. Disregard a Natural Law and - as one High School student said - you get zapped. To help us to avoid the "zap" we make up rules, which are homely guides to action. A rule is obeyed because it is in our interest to obey - even if we are unaware of the Natural Law on which it is based. The rule to reduce the speed of your car when rounding a corner is obeyed by people who know nothing of Newton's Laws of Motion that give authority to the rule.

### Laws and Privileges

Rules may be made into "laws" by legislative bodies. The encoded rule

includes a deterrent penalty less crucial than the "zap" of a disregarded Natural Law. People agree with laws for they are sensible and fair. The speeding driver - caught in a school zone - doesn't curse the system, but his own stupidity. His anger is directed not against the law, but against himself. Scant sympathy is reserved for the law-breaker by others in the community and this reaction furnishes a guide for legislation. For, not all things legal are laws: some are private laws or "privileges" and these are neither sensible or fair. They breed resentment and evasion and an increasing cynicism which spreads to include laws - a trend accelerated by the skillful presentation of privilege as law. The people most responsible for the breakdown in law and order are those who support privilege and order.

The most important characteristic of a privilege is the benefit it provides one at the expense of another. Values move in one direction without recompense - a "one-way exchange." George called these "values from obligation" but erroneously included mortgage payments - which are presumably contractual. We can make further statements at this time:

- \* law-breaking and privilege-breaking are said to be a "breakdown in morality": rather, are they changes in morality;
- \* changes in morality may be more or less ethical;
- \* understanding may lead to a more ethical morality, but ignorance will assuredly lead to a less ethical morality;
- \* laws buttress a community's viability, but privileges will destroy it;
- \* the maintenance of privilege requires ever greater force;
- \* justice is the most ethical morality;
- \* the allocation of natural resources may be contractual or enforced (lawful or privileged).

### Cooperation and the Growth of Civilization

Civilization is synonymous with cooperation. It begins with the first act of cooperation - whether voluntary or involuntary. The extent of a civilization may be measured by the amount of cooperation and the quality by the percentage of cooperation which is voluntary. The morality (code of conduct) accepted by voluntary cooperators may be given the name "economic": the involuntary morality may be called "political."

A useful scientific strategem is the construction of an unreal model (such as the physicist's frictionless machine) to demonstrate relationships. This well-established precedent may be followed by our construction of communities which are purely voluntary and purely involuntary; then comparing their characteristics. When the community is:

	<u>VOLUNTARY</u>	<u>INVOLUNTARY</u>
it is called	freedom	slavery
and its morality	economic	political
results in values	from production	from obligation
it is governed by	laws	privileges
passed by	choice	compulsion
and are	contractual	obligatory
enforcement is by	responsibility	coercion
backed by the	authority	power
of	reason	force
and the doctrine of	equal rights	social rights
from the concept of	individuality	statism

These extreme characteristics may be used to examine "mixed systems" the inelegant term for the real world. It is usual for students to study "Comparative Economic Systems" (or the same thing called "Comparative Political Systems") by comparison of their overt character, a procedure that leads to prolonged effort but little understanding. Or, the popular descriptions of political systems - socialist, communist, republican, democratic - are used as if they had meaning. One can give them meaning by attaching them to defined concepts - perhaps like this.

A community is either free or not. Any interference, by force, with a free community makes it not "less free" but unfree. Similarly, a slave is still a slave no matter how comfortable his condition. When non-contractual values pass without recompense from one to another, the payer is enslaved and his community is not free. Statism erupts in many forms and reliance on their varied and interchangeable naming leads to confusion. Most often met are those vague terms "socialism" and "communism" so let's pin them to defined concepts. The path to statism may be through constitutional change or through the use of violence. The collective that results from the use of violence and armed force, we shall call "communism"; the collective that occurs through constitutional methods, we shall call "socialism." So Britain and Chile are socialist and Cuba and Russia are communist.

### Capital and Interest

The most complex and difficult matters may be simplified by use of the tool of classification. The entire universe may be reduced to the four concepts labelled Land, Labor, Capital and Wealth. George followed the example of his predecessors and used these concepts albeit with some revision. One is so impressed with the careful precision of

George's argument that criticism is suppressed, at least until the subject of Capital and its return is discussed. Even then, the thrust is indirect, for his Interest theory is attacked for its weakness when compared with his forceful Ricardian analysis of Rent and Wages.

Political economy is not concerned with a situation where producer and consumer are one. The "science of the natural social order" examines cooperation and therefore exchange in the community of Man. The completion of exchange is the limit of examination. The description of the science as a study of "the nature, production and distribution of Wealth" implies that when production is completed so also is the interest of the scientist. But the "incomplete" product is called Capital and is said to be "not in the hands of the consumer" or "in the course of exchange."

So we are left with three categories of interest to political economy: Land, Labor and the product of these two - Capital. But the implication of Capital is that it is "moving": it is not a final product but a continuing product and that "time" is involved. Whether the product is being produced, whether it is helping the production of other products, or whether it is in a warehouse awaiting a propitious occasion, the product is Capital and time is - indeed - of the essence.

Interest theories may be grouped under the heads: productivity; time; and (inevitably) mixed. When it is understood that productivity arises from exertion which is paid for with Wages, two of these groupings can be dismissed. The grouping that is left is "time."

People prefer satisfaction at once and require compensation if they must wait. This compensation is Interest. However, there can be no delay of satisfaction unless the satisfaction is available to be delayed. So, exertion must be spent to create satisfaction (Wages) which is then delayed for an additional reward (Interest).

It might be argued that Interest is also a return to Labor for the exertion required to decide to delay rather than take at once! But delay is not restricted to Labor: the Rent recipient might delay if the price is right. It seems valid to cite instances where the exertion is equal, but the return is different - with the difference relating to time and called Interest.

To sum up, we may say that in simple pre-political economy the two Factors of Production - Land and Labor - produce Wealth. When cooperation (civilization) begins and thus political economy, Time enters as a third Factor and combines with the other two to produce Capital. Capital is produced (values increase) until the product reaches the consumer whereupon it becomes Wealth and is used (values decrease).

Again, we may make some statements:

\* Time is always involved in political economy as the

third Factor of Production;

- \* The result of successful production is Wages and Interest and sometimes Rent;
- \* The cost of production is exertion and time, or more precisely fatigue and tedium;
- \* We should re-examine George's "time" theory (reproductive nodes).

### Rent and Land Value

Rent and Land Value are not the same unless they are so defined, but that would be an unnecessary complication - as well as wasting a word. They are, however, useful terms to attach to values of land that occur under different circumstances. These different circumstances are values that occur in a free market and those that occur in an unfree market.

Two conditions are necessary to a free market. There must be no obstacle to production and there must be no obstacle to contact between buyer and seller. When this is so, the "price mechanism" works effectively to bring the market always to an equilibrium. A shortage causes a price increase which stimulates production and supply which - in turn - satisfies demand and lowers price. An oversupply acts in a reverse manner to accomplish the return to balance.

Neither Labor nor Capital can resist the pressures of the market. To avoid the weariness that is the undesirable accompaniment of both fatigue and tedium it is necessary to react to competitive signals. It is instructive to examine the nature of these Factors of Production and then to compare our findings with a similar examination of Land.

A toolmaker (labor) must take the best job that is offered. Should the offered \$3 per hour be less than he likes, he takes it anyway - but he watches for the \$4 offer. He takes the \$3 because failure to work invites starvation. Each hour unworked is lost income - never to be recovered. Each hour worked for less than the best market rate is "fewer desires satisfied for more exertion expended" and therefore contrary to the basic objective of the toolmaker.

A similar argument applies to Capital. One does not make Capital with no thought of reward. It is not an idle pursuit lightly undertaken, but a serious effort to fulfill the least exertion principle. Unless Capital is profitable it does not remain Capital, but reverts rapidly to Wealth (and is consumed). Further, Capital is specialized in its form and function. If you find that the bicycle near completion is unwanted, you cannot easily change it to a stepladder that is desired. Much Capital is locked in to a location in the form of roads, sewers, or office skyscrapers. Such Capital must make its return over a period and pay for itself in addition for trade-in value is minimal.



So, both Labor and Capital come quickly to market eager to fulfill a need and, incidentally, confirm the "invisible hand" prediction of Adam Smith.

Not so with Land, and the reason is not difficult to uncover. The conditions of a free market are mobility – the buyer and seller must get to the market with their wares: also, unrestrained production – for the producer must be able to react to price changes.

Mobility is not a factor with Land, for its market is where it is. Land is not carted to the buyer: rather does the buyer come to his purchase, which is then claimed or occupied. Production restraint is also not a consideration for, by definition and observation of the obvious, Land is finite. So, supply – rather than production – is the issue and supply is for all practical purposes infinite. From what we know now, we can safely say that without stepping off our planet we have such a profusion of natural resources that all our desires may be satisfied into the foreseeable future. We can amend our second condition to "no restraint on supply" for a free market to apply.

Now we can compare Land with Capital and Labor – or perhaps we should merely compare Land and Capital as Capital is the material embodiment of Labor. Again, some statements:

	<u>LAND</u>	<u>CAPITAL</u>
Is exertion necessary to its existence?	NO	YES
Does non-use diminish its value?	NO	YES
Is there a cost to the holder, but non-user?	NO	YES
Does it make sense to acquire ever-greater quantities in the hope of eventual appreciation?	YES	NO

Many similar statements could be made to underline difference, but the following two may summarise them:

The creation of Capital costs exertion and time and must be rewarded or Capital will no longer be created or maintained as Capital. Capital that does not earn its way is exchanged at the first opportunity. Any delay reduces the average earnings of the Capital over the entire period of its existence, so expedition is the order of the day.

The creation of Land costs no time and no exertion. Any return on an investment of nothing is desirable and return there is. However, the return requires no exertion on the part of the landholder. Rent – the return to Land – arises from the actions of others as they affect the relationship of more productive Land with the Margin (the best available Rent-free Land). So, one can travel about one's business with no thought of the Land one holds: perhaps only to await the pleasant gratification that accompanies an unearned income.

But the income that is unearned pales before the capitalization of that income, which is somewhere between ten and twenty times as much. It is an easy step from capitalization of Rent to capitalization of potential Rent. The term "potential Rent" is an interesting one for it arises in the discussion of "highest and best use" among appraisers and Assessors. The implication of "potential Rent" is that actual Rent is not being collected; that circumstances are such as to make the collection of Rent less profitable than the increase in capitalized Rent. In other words, a "potential Rent" increase of \$5 per year might be preferable (at a five per cent rate) to an actual collection of \$95 per year from your Land.

Capitalization is pretty heady stuff. A booming economy can create fortunes for no cost in exertion to the lucky Land-holders. As Capital appreciation generally receives more favored treatment than income when taxes are levied, a further incentive is applied. The step from naturally created values to values resulting from privilege is a short one and is quickly taken. A 10¢ subsidy to bus-riders per trip doesn't seem much and is advocated and legislated for the benefit of the poor. But this small amount is 20¢ per day or \$1 each five-day week. This translates into a subsidy of \$50 each year or a capitalized \$1,000 for each recipient. This is multiplied in turn by the potential capacity of the Land to house families. Twenty families in an apartment house - each of whom gets a subsidy transit benefit of \$50 per year - means an additional \$1,000 syphoned into apartment rent. This increased "productivity" will raise the sales price of the Land by \$20,000.

Yet this pales beside the increase caused by a large public (or private) improvement. The character of a neighborhood can be altered most profitably by a major construction. It is understandable that a foremost concern in the minds of Land-holders is the supermarket, freeway, school, library, sewer-system, subway line, theater, that will be built in strategic proximity to his Land... almost at once.

For fortuity is expected soon and this effects a paralysis in Land improvement. A commitment to Land at today's value may make difficult or impossible an effective exploitation of next year's super-value. If such ripe Land (all Land is ripe) is used, it will be for temporary purposes under conditions of non-involvement.

One or two more strokes are necessary to complete the sketch. Except in a technical sense, construction of any sort does not affect a large area. Value outreach is limited to the immediate area and drops away sharply with distance. Least desirable is for the improvement to be erected on one's own Land. Better to have Land next to the improvement, for then your value will be enhanced by the activity of the improvement. Better yet! To own the third in line and benefit from the building of the first two - or the fourth, fifth, six, or best of all the last piece to be used and therefore the beneficiary of values created by all that went before!

Not for Land the urgency that impels Labor and Capital to the market. The greatest return accrues to the last to sell and the paralysis deepens and widens. Strangely enough, to feed upon itself! As has been noted, influence on land value is restricted in effect. The one-acre factory can be built on any one of a thousand acres. In every one of the acres will be hope for the lightning strike close by and the inevitable riches. So a most modest building program will freeze an enormous area of expectancy, until marginal and sub-marginal Land is caught tight. And, with each expansion of Land-holding to poorer and less productive locations, so do all more productive Lands increase their value.

Unfortunately, this is not wild imagery, but a picture of the real world with great tracts of most productive Land held hostage for a ransom that may never be paid.

The "price mechanism" regulates the returns to Labor and Capital and ensures their appropriateness. The return to Land is not a payment for productivity, but a premium for possession. Overpayment to Labor or Capital of Wages or Interest is confirmed by the market - which adjusts the returns accordingly. Overpayment to the Land-holder confirms the higher price to other Land-holders and a general increase results.

I suggest that this return is not comparable to Wages and Interest and should be given the name Land Value. It consists of Rent plus a speculative premium arising from natural monopoly.

I suggest that the free market return to Land be called Rent, but the immediate question is how may this free market return be found? Anything will be held if there is potential gain and no cost.

It will not be held if cost offsets any potential gain. If there is a charge on Land-holding (and it is sufficient) the Land will not be held for some anticipated benefit.

This is the economic justification for the full collection of Rent. Not that revenue is collectible - or should be collected - but that the result of such a full collection is to subject Land to the same pressures as the other two Factors. The doctrine of laissez-faire has stumbled far too often over the anomalous pairing of the free market with natural monopoly. Here are some final statements that arise from the foregoing:

- \* The "speculative premium" that turns Rent into Land Value parallels the economists' "quasi-rent" of Labor and Capital;
- \* Both Rent and Land Value are annual returns which when capitalized are called Sale-Price;
- \* Rent and Land Value plots of a city are extraordinarily different. The present Land Value map shows a tapering away from the central city, then a shallow drop out to the boondocks. The "expectancy area" that floods out from

any threat or promise of activity extends far beyond any Rent influence. A Rent map will peak in the central city - far above the central Land Value - then drop away sharply to the city edge where it will reflect the general advantage provided by basic improvements such as roads and sewers;

- \* The Rent collecting society will not be a "diffused population" type as suggested by George. Rather, will people be very highly concentrated into cities, for in such circumstances can cooperation reach its highest level. But, it will be a voluntary combination of skill and knowledge in which one will be drawn not driven to the city;
- \* Both Rent and Land Value may be described as a total of advantages less disadvantages that attach to Land;
- \* All taxation now comes from Land Values.