ECONOMICS THE <u>POLITICAL</u> SCIENCE

A Study of the Corruption of Economic Concepts

V.H. BLUNDELL

"We shall test the validity and relevance of economic concepts and economic laws and we shall note how some of these have been rejected, corrupted or ignored by both the classical economists and the modern economists alike....

"Other sciences are comparatively free from political influence.... But economics is a necessary tool of politics, which sectional interests utilise with great vigour, producing a cornucopia of economic fallacies to sustain their arguments."

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CHAPTER 1

The Rule of Nature

THE words "political economy" originally meant the economy of the state as opposed to the domestic or individual economy. "Political" (from the Greek "politikos") meant pertaining to the state or nation; "economy" (from the Greek "oikonomos") meant simply household.

When the word political was dropped and the word "economics" used, the subject matter itself was expanded to embrace concepts not strictly related to the original study. This, with a change of emphasis, has led to the neglect and downgrading of some of the most important concepts and principles dealt with by the classical economists, who invariably entitled their treatises "political economy" and referred to the subject matter as a science. Thus: "the science of political economy."

Henry George, in his own *The Science of Political Economy*[1] makes the point that the use of the term began at a time when, in economics, the distinction between scientific laws and man-made laws was not clearly made, and the economy of the community or "body-politic" was assumed to be the business of the state to regulate or control[2]. It was not until the advent of the French Physiocrats, led by Francois Quesnay (1694-1774), that the subject matter was treated as a science and this distinction made clear.

Physiocracy meant "the rule of nature" and the

Physiocrats, with their cry of *Laissez-Faire!* argued that it was no business of the state to regulate and control the "body politic" - this could safely be left to natural economic laws. The Physiocrats used the term "political economy" to mean the science of natural laws in the production and distribution of wealth divorced from *politics.* The term remained in use throughout the time of the classical economists and, although "economics" as taught today is allegedly separate from the study of politics, in that it is supposed to eschew value judgments, it nonetheless implicitly accepts the original notion that it is the business of the state to intervene in economic affairs rather than to leave them to individuals in the community.

It is difficult to argue today (though many do) that governments should abstain entirely from intervention in the economic life of the country, particularly when the problems needing attention are the result of previous intervention. But the primary purpose of the study of political economy should be to establish the existence and function of the laws of economics, because political nostrums are too frequently foisted upon the people in ignorance or defiance of these laws, with consequent failure of purpose.

This book, entitled *Economics - the Political Science,* has the emphasis upon "political", using the word in its present-day sense. Other sciences are comparatively free from political influence - some entirely (mathematics) and others to a more limited extent (medicine). But economics is a necessary tool of politics, which sectional interests utilise with great vigour, producing a cornucopia of economic fallacies to sustain their arguments and, when confronted with propositions based upon economic laws, they frequently deny that economics is a science at all.

We shall test the validity and relevance of economic concepts and economic laws and we shall note how

some of these have been rejected, corrupted or ignored by both the classical economists and the modern economists alike. This should enable us to appraise, from sound premises, both criticisms and expositions of currently-held economic ideas.

We can start with the basic law of political economy – the law upon which all other laws of economics depend and which by many has not been fully comprehended or has been misunderstood, or denied.

It is the law that "man seeks to satisfy his desires with the least necessary exertion." It results in the "invisible hand" of Adam Smith where each man acting in his own self-interest (in economic transactions) automatically furthers the interests of others. It is the basis of the division of labour, the law of competition, the law of variable proportions, etc.

It need hardly be said that this fundamental law of political economy does not mean that man always succeeds in achieving "least exertion", though he always aims for it. Lack of requisite knowledge may hamper or defer his objective; others may attempt and succeed in thwarting him, but his objective will be the same. Further, in pursuance of an even more dominant desire, a subsidiary desire may be satisfied with more exertion than was either necessary or (in isolation) desirable. But this confirms rather than invalidates the basic law, e.g., a man will take a longer route to a shop to satisfy his desire for an evening newspaper in order to visit an inn to satisfy an even stronger desire for a drink; or a man will walk to his destination in his desire for exercise, using more exertion than would be necessary if he went by car. Legislation affecting economic action in society which attempts to override this basic law is really attempting to legislate against human nature.

It is frequently alleged that economics is a heartless science, that man, unless he orders things differently, is at the mercy of economic forces which

produce poverty, hunger, unemployment, etc.; and that economic theory lacks compassion and humanity and that society should not blindly follow the dictates of economic theory.

The error in this reasoning is in assuming that it is within the province of man to defy, regulate, change or ignore economic laws so as to produce a more acceptable arrangement of the production and distribution of wealth.

But economic laws are neutral. Like the sunshine and the rain, they fall upon the just and the unjust alike and, although one may meddle with the *effects* of economic laws, the thrust or tendency of these laws cannot be varied or changed.

This is not to deny that compassion, humanity or social justice have a place in the arrangements of man-kind, but such considerations properly belong in that branch of philosophy known as ethics or, as others will have it, the study of moral laws. ' For the purpose of arriving at a better state of society, both studies are necessary. They must be combined but kept separate, in the same way that the study of the generation of energy in an engine must be a separate study from that of inertia or friction, yet both combined to get the engine moving.

An important proviso in predicting the course of an economic law is, *ceteris paribus* - in more popular language, "other things remaining the same."

The fact that few things remain constant for any length of time in a country's economy explains the difficulty of economic forecasting; the variables tend to swamp the constants. It is, of course, in forecasting the course of the economy that major disagreements among economists arise.

This, however, does not mean that all forecasting (based upon sound economic theory) is unreliable for, often, known variables can be allowed for and a margin of error established, but without a knowledge of economic laws, forecasting would be downright impossible.

Economic laws are no more precise than many laws in physics and chemistry, where time lags play an important part in their operation. Thus laws are tendencies, though immutable. Water will always seek its own level, but may not achieve it instantly; it may take time, but the pressure or tendency is always there. Economic laws function in similar fashion. What often happens when an economic law asserts itself over a legislative one is that another law is enacted to deal with the new situation.

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1 *The Science of Political Economy*, page 47, Robert Schalkenbach Foundation, New York, and Land & Liberty Press, London.

2 *1615 Traicte de l'Economie Politique*, Antoine de Montchretien.

CHAPTER 2

Wealth and the Confusion of Terms

IT IS now necessary to examine the nature of wealth, the subject matter of political economy, for – surprising though it may seem – a consistent and unambiguous definition of the word has not yet been agreed among economists and this has important consequences, as we shall see.

Before we proceed, however, a question which may already have presented itself is why professors of political economy not only fail to agree among themselves on the causes of and cures for our many economic ills, but also fail to agree on the fundamental concepts and principles upon which the science must rest. No wonder there is a widespread belief that economics is not a science.

To what extent professors of political economy today are precluded by the nature of their employment from an objective approach to their subject it might well be hard to establish – if it could be established at all. Henry George in his introduction to his *The Science of Political Economy*[1] made some interesting observations on the effect that politically-motivated parties had upon the teaching establishments:

"In the supreme practical importance of political economy we may see the reason that has kept and still keeps it in dispute, and that has prevented

the growth of any body of accepted and assured opinion.

"Under existing conditions in the civilised world, the great strength among men is for the possession of wealth. Would it not be irrational to expect that the science which treats of the production and distribution of wealth should be exempt from the influence of that struggle?.... Economic truth, under existing conditions, has not merely to overcome the inertia of indolence or habit; it is in its very nature subject to suppressions and distortions from the influence of the most powerful and vigilant interests. It has not merely to make its way; it must constantly stand on guard. It cannot safely be trusted to any selected body of men, for the same reasons that the power of making laws and administering public affairs cannot be so trusted. Colleges and universities, though ostensibly organised for careful investigation and honest promulgation of truth, are not, and cannot be, exempt from the influences that disturb the study of political economy, they are especially precluded under present conditions from faithful and adequate treatment of that science. For in the present social conditions of the civilized world nothing is clearer than that there is some deep and wide-spread wrong in the distribution, if not in the production, of wealth. This is the office of political economy to disclose, and a really faithful and honest explication of the science must disclose it.

"Whoever accepts a chair of political economy must do so under the implied stipulation that he shall not really find what it is his professional business to look for."

Strong words but how true is this today? Are there influences, of whatever nature, that hinder objectivity in our schools and colleges?

Whatever our views on this matter, at least we

should remain sceptical and on guard against innocent or contrived pitfalls into which we may be led by those to whom we are expected to look for guidance on economic matters.

To return to the subject of wealth. As we know, in defining terms the ideas or concept precedes the definition. In scientific study we label a concept for identification, being careful not to use that word for any other concept without qualifying words - although even this can have its dangers.

It is too late to devise new scientific terms and we are stuck with the term wealth. What we must do is grasp its general meaning and sharpen its image by excluding under its heading contrary or different concepts for which other words are readily available through similar usage. Thus, the concepts of nature, man and man's products and the subdivision of man's products into what we loosely call tools of production, should, in order to avoid confusion, have separate distinguishable terms. This, however, has not been done (except by Henry George) throughout the whole history of economic thinking and today, economic terms are not only used loosely, but also the same terms are often used with different meanings and the same meanings often expressed with different terms.

Thus, the concept of the resources of nature, instead of being rigidly confined to the classical economists' own term "land" is frequently included with man's products under the heading wealth or capital.

The word property is often used when land is meant but, while all land may be designated property, not all property is land. Thus the words "the rights of property" or "the earnings of property" when used in economic discussions serve only to confuse the issue.

In the purely *legal* sense of the term, land includes all that is attached to it, so buildings become, in this context, land. The legal profession may have its own problems but there is no room for

this kind of confusion in economics.

Henry George in his *The Science of Political Economy* (Chapter I Book II) listed twenty-four different definitions of wealth used among as many writers on political economy and quotes Professor Perry (*Elements of Political Economy*, 1866) thus:

> "The meaning of the word wealth has never yet been settled; and if political economy must wait until that work be done as a preliminary science will never be satisfactorily constructed.... Men may think and talk, and write, and dispute till doomsday, but until they come to use words with definiteness, and mean the same thing by the same word, they reach comparatively few results and make but little progress."

The situation was no better fifty years later when J.E. Symes, Principal of University College, Nottingham, in his Political Economy (1906) makes the following statement:

> "By wealth we mean all material objects of human desire which are not to be obtained for nothing.
> "There are three kinds of wealth:-
> (1) Such material *gifts of nature* as can be monopolised (natural wealth);
> (2) Such material *products of labour* as are direct objects of human desire;
> (3) Such material products of labour as are devoted to the production of other objects of desire."

This confusion extends to the author's discussion on wages:

> "The remuneration for ability is analogous to rent (of land) if the ability is natural; but to interest if the ability is acquired."

Neither Samuelson[2] nor Lipsey[3], whose works are

standard texts for universities, bother to define wealth. Lipsey refers only to the "national product" and "national incomes". Samuelson follows a similar line and refers to the distribution of goods and services and their scarcity.

B.V. Marshall, senior lecturer in economics at Portsmouth College of Technology, has written a 750-page volume, in which wealth is classified as follows:

"(i) Wealth as the property of individuals,
(ii) Wealth as the property of firms,
(iii) Wealth as the property of public authorities."

J.L. Hanson, one time senior lecturer on economics at Huddersfield College of Technology, another widely-read writer on economics and author of seven books on the subject, also classifies wealth into three groups: (1) personal wealth, (2) business wealth and (3) social wealth, the latter including publicly-owned "property", schools, libraries and "assets" of nationalised industries and coal mines.

Honor Croome, whose book *The Approach to Economics*[4] has gone into at least ten editions, and who was a student of the London School of Economics, says that national wealth is the wealth owned by all the persons inhabiting the national territory. By implication, wealth, although not strictly defined, appears to include anything that has a value.

Another author, Arthur Coe, to whom no economic qualifications are credited, says in his book *Economics for Everyman*[5] that political economy is neither an art nor a science but a system of conduct and legislation founded upon science and which directs the arts. This is basically a quotation from Ruskin who, whatever his virtues in other fields, was certainly no economist nor was he ever regarded as one. Coe, despite his plea for clear definitions (page 14), says on page 158 that the *capital* of a

country consists of the means of production available to it and may be divided into three categories: (1) the workers, (2) land and minerals and (3) machinery, tools and tackle. It is therefore not surprising that his book is a mass of confusions and contradictions.

It would appear that the most astute writers of economic textbooks avoid a definition of wealth and those who do attempt a definition usually end up in confusion and inconsistencies.

When we consider that slaves (labour) and paper money (a written promise) have both been included in the term wealth, we arrive at the situation when all the factors of production and the means of exchange, along with the products themselves, have been designated wealth!

It can be seen that failure to distinguish the products of man from the gifts of nature – and from man himself – has obscured their function in the economy and consequently the economic as well as the ethical implications of private ownership of these factors.

It was easy in the days of slavery to defend, by implication, the ownership of slaves by including them under the term wealth, or using the substitute word "property" so that in defending the rights of slave owners one was merely defending the rights of property!

In like manner is the significance of land, with all its vital economic ramifications, obscured when it is regarded simply as a form of wealth.

It will be noted that a distinction is frequently made between national wealth and the wealth of individuals and that certain things usually regarded as wealth to the individual are not necessarily regarded as part of the wealth of a nation.

But what of land owned by an individual? Is this part of the national stock of wealth? One might be tempted to answer yes. Is not land property, or wealth? Not so, and not merely because we wish to

define land differently but because it *is* essentially different. A moment's reflection shows that the ownership of land is not the ownership of wealth, but the ownership of a factor without which wealth could not be produced.

The confusion of land with wealth is due largely to regarding wealth as being anything that has a value - which land certainly has. Thus, including land under the term wealth because it has value obscures the fact that the ownership of land makes people wealthy not because land is wealth, but because it enables them to abstract wealth from others for permission to produce. The best example of this is in crop-sharing where the owner of land, simply by virtue of ownership, claims a share of the crop (wealth).

Theories of value have had an important effect upon the confusion as to the nature of wealth and more importantly, upon claims to it, and these theories will be the subject of the next chapter.

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1. Robert Schalkenbach Foundation, New York and Land & Liberty, London.
2. *Economics. An Introductory Analysis.* Paul A. Samuelson, McGraw-Hill.
3. *Positive Economics.* Richard G. Lipsey. Weidenfeld & Nicolson.
4. Published by Christophers.
5. Published by Chapman & Hall.

CHAPTER 3

Development of the Labour Theory of Value

ABSTRACT notions of value would appear to be of little importance today and concrete notions of value are taken care of in the market place - so why bother? The fact is that the different concepts of value - and there are many - have conditioned our economic thinking in subtle ways and have insidiously impinged upon ethical judgments.

Despite the volumes that have been written on the subject and the confidence of their authors, there is still uncertainty as to the nature of value and its place in current economic thinking.

Peter F. Drucker who, as a writer, lecturer and expert on business management, enjoys a worldwide reputation, has called for a new theory of value. The need for this he explains in an article: "Towards the Next Economics" published in *The Public Interest*, 1980 (National Affairs Inc.). But more on his views later.

In making a definition of wealth, economists found they were obliged to refer back to value. They sensed that, while all wealth appeared to have value, not all things considered to have value fitted in with their conception of the nature of wealth.

Value was linked with utility, fresh air and water had utility and yet in one sense they had no value.

To overcome this difficulty the idea of scarcity was introduced. Things, to have value, had to be

scarce, that is, they could not be had for nothing. Thus, fresh air, water, pebbles on the beach, etc., have no value because they are not scarce although they may have utility.

But even this concept did not resolve the matter. The more scarce the article, the more valuable it was, yet this led to the absurdity that, if the quantity of goods in a country became more plentiful, then they were less valuable and the nation had suffered a decline in wealth. Nor could it be satisfactorily held that, if goods became scarce, this constituted an increase in wealth.

Wealth, value and utility (usefulness) could not be brought together in an acceptable relationship.

It was Adam Smith in his *Wealth of Nations* who established the distinction between "value in use" and "value in exchange", although the idea did not originate with him. This resolved part of the difficulty. Value in use, or usefulness, had no direct relationship with value in exchange or market value, and this usefulness did not dictate market value. Diamonds had little use but a high exchange value. One can see how useful a screwdriver, a needle or a can-opener, can be when one considers the alternatives, but these articles, though having a high value in use, have a very modest exchange value. Used stamps, a penny-farthing bicycle, or Bernard Shaw's fountain pen, have little or no value in use, but have an exchange value well demonstrated if they are put up for auction. The first edition of a book is certainly no more useful than a modern edition, yet such a book would exchange for many times more than the modern one.

Subsequent economists, however, while accepting the terms of distinction between value in use and value in exchange, got confused over the distinction itself, and this confusion has remained right through the marginal utility theory to the present day.

The marginal utility theory of value, once it became established as a substitute for the labour

theories of value, was slavishly followed by writers of economic textbooks, as a glance through those now in current use will testify. But some economists now reject it, as Henry George[1] did when it first became current.

George Soule, in his *Ideas of the Great Economists*[2] says of the marginal utility theory:

> "All this is very ingenious, but how relevant is it to the real economic world? The extreme mechanistic abstraction of the theory raised doubts. Picture a befuddled consumer, making out an expenditure budget on a form far more intricate than an income-tax blank, drawing up schedules of preference for all his wants, deciding on the last unit of each product he would buy at a given price. Of course no consumer ever does such a thing. Even businessmen make no deliberate marginal calçulations; their records contain no equations and graphs of the sort found in economic textbooks....
>
> "What can you *do* with a theory like this?.... Carried out to all its implications of general equilibrium, and revealing an allocation of resources in such a way as to offer consumers exactly what they want in the order of preference in which they want it, at the lowest possible prices, the theory is little more than an impressive elaboration of Adam Smith's "invisible hand" that leads everyone to serve the best interests of all if only he intelligently pursues his own advantage."

Peter Drucker, who, as mentioned above, is calling for a new theory of value, is himself reverting to a labour theory of value, although in his article it is not specifically expressed in those terms.

To see the whole argument in perspective, we must trace the theories of value from their recognised beginnings and observe how and *why* some of the controversies arose.

In *The Wealth of Nations* (which is as far back as we need to go for our purpose) Adam Smith, in expounding his labour theory of value, said that the exchange value of an article is equal to the quantity of labour which it can purchase:

> "Labour is the real measure of the exchangeable value of all commodities. Toil and trouble is the real cost of acquiring anything. The possession of things saves the toil of acquiring them. They contain the value of a certain quantity of labour which we exchange for what is supposed at the time to contain the value of an equal quantity."

Smith, however, said that, although labour was the real measure of exchangeable value of all commodities, it is not that by which their value is commonly estimated. Smith saw the problem of attempting to measure labour in any uniform way. There were different forms of effort, there was skilled and unskilled labour, there was experience, ingenuity, etc. His conclusion was that, although labour was the *originator* of value, its *measure* could be found only in the market place.

One can see the truth of this when one considers the abortive use of labour which results in a product not in demand, unsaleable, out of fashion, or lacking in those qualities which an alternative or improved product may offer for the same labour cost.

Money, says Smith, is the exact measure of the real exchangeable value of all commodities, but he adds the proviso that this is only true at the time and in the place that the transaction takes place.

Up to this point, Smith's theory of value leaves out that value added to a product by the use of capital. He then says that a man's "stock" (capital) entitles him to a return in exchange for the additional value it has given to the products.

Adam Smith then goes on to include land as a contributor to the value of the finished product and

specifies rent as the share of value that goes to the landlord:

> "As soon as the land of any country has all become private property, the landlords, like all other men, love to reap where they never sowed and demand a rent even for its natural produce ... which, when the land was in common, cost the labourer only the trouble of gathering it."

This rent, says Smith, makes a third component part of the price of commodities, to which he adds:

> "The real value of all the different component parts of price, it must be observed, is measured by the quantity of labour which they can, each of them, purchase or command."

Thus did Adam Smith arrive at his theory of value, although he later contrasts market value with monopoly value and explains the difference.

Ricardo accepted Smith's labour theory of value and the distinction between value in use and value in exchange. Further, he accepted Smith's contention that "labour is the real measure of the exchangeable value of commodities". But Ricardo questioned that the value of a commodity is *made up* of the rent of land, profits of capital and wages of labour.

Since rent is a surplus which arises from land above the margin (i.e. after the costs of production have been met), Ricardo argued that rent was not part of the value of a commodity, so, since capital is but stored-up labour, this leaves only labour as the originator of value. This was qualified in this passage:

> "There are some commodities, the value of which is determined by their scarcity alone. No labour can increase the quantity of such goods, and therefore their value cannot be lowered by an increased

supply. Some rare statues and pictures, scarce books and coins, wines of a peculiar quality, which can be made only from grapes grown on a particular soil, of which there is a very limited quantity, are all of this description. Their value is wholly independent of the quantity of labour originally necessary to produce them, and varies with the varying wealth and inclinations of those who are desirous to possess them. These commodities, however, form a very small part of the mass of commodities daily exchange in the market. By far the greatest part of those goods which are the objects of desire are procured by labour."

When later economists criticised Ricardo, they could not see how rent could *not* be part of costs of production and therefore part of the value of goods produced.

It is now generally accepted that rent is not part of the *unit price* of goods although part of the *total* price of the goods received in the market. Rent, in short, was obtained not as part of the unit price but as part of whole price which was contained in the surplus production of superior land.

The value of an article was therefore the same when derived from no-rent marginal land as when derived from high-rent land.

If it is reasoned that rent contributes to value, it tends to obscure the nature of rent. If, however, rent does not contribute to value but takes a share of production represented by the surplus attributable to above-margin productivity, then rent takes value *created by labour* on superior land. The politics of this question begin to emerge.

As for capital being mainly stored-up labour, here is Ricardo:

"If we suppose the occupations of the society extended, that some provide canoes and tackle necessary for fishing, others the seed and rude

> machinery first used in agriculture, still the same principle would hold true, that the exchangeable value of the commodities produced would be in proportion to the labour bestowed on their production; not on their immediate production only, but on all those implements or machines required to give effect to the particular labour to which they were applied."

However, one must be careful how the argument is used. If it were not for the political conclusions derived from theories of value, the matter might be only of academic interest. But when labour claims all the credit for the creation of value, it is again a short step to reason that labour is entitled to all the value created. However, this will obviously not do, for once labour has been paid and the value it created in exchange for it transformed into capital, there can be no further claims by labour for the contribution capital has made.

We now come to John Stuart Mill's views of value. Mill begins his treatise by emphasising the very great importance of the theory of value. It is, he said, fundamental.

> "Almost every speculation respecting the economical interests of a society thus constituted, implies some theory of value: the smallest error on that subject infects with corresponding error all our other conclusions; and anything vague or misty in our conception of it, creates confusion and uncertainty in everything else."

Mill was so confident that he solved all the problems of value that he wrote:

> "Happily there is nothing in the laws of value remaining for the present or any future writer to clear up; the theory of the subject is complete."

Mill accepts Adam Smith's distinction between value in use and value in exchange but accuses him of falling into ambiguity in his exposition of it.

> "Things (Smith says) which have the greatest value in use have often little or no value in exchange, which is true, since that which can be obtained without labour or sacrifice will command no price, however useful or needful it may be. But he proceeds to add that things which have the greatest value in exchange, (as diamonds do for example) may have little or no value in use. This is employing the word 'use' not in the sense in which political economy is concerned about, but in that other sense in which use is opposed to pleasure. Political economy has nothing to do with the comparative estimation of different uses in the judgment of a philosopher or of a moralist. The use of a thing in political economy means the capacity to satisfy a desire or serve a purpose. Diamonds have this capacity in a high degree and, unless they had it, would not bear any price. Value in use is the extreme limit of value in exchange. The exchange value of a thing may fall short to any amount of its value in use; but that it can ever exceed the value in use implies contradiction. It supposes that persons will give to possess a thing more than the utmost value which they themselves put upon it as a means of gratifying their inclination."

Here Mill is guilty of ambiguity and confusion himself. As Henry George in his *The Science of Political Economy* points out:

> "Mill, after accepting the distinction between value in use and value in exchange and stating that only value in exchange has any relevance in political economy attempts to show some kind of relationship between the two kinds of value."

If (as Henry George states) Adam Smith was wrong in saying that the exchange value of a thing may be more than its use value, could Mill be right in saying that the exchange value of a thing may be less than its use value? If value in use is the highest limit of value in exchange, is it not necessarily also the lowest limit?

All this may seem highly irrelevant to the main issue but, as Henry George points out, it put "value in use" back into the realms of political economy and paved the way for the marginal utility theory of value.

Thus, although Mill endorsed the labour theory of value and the distinction between value in use and value in exchange, he left the door open for future theories of value that would contradict it.

To summarize:

The labour theory of value, displaced by the marginal utility theory of value for reasons which invite the question of objectivity, is by no means disposed of, despite its ambiguities, and the marginal utility theory is not now so universally accepted as it once was.

Adam Smith established the distinction between value in use (usefulness) and value in exchange (market price), and also between the originator of value (labour) and the determinator of value (the market). He acknowledged the contribution made to value by capital. Though sound to this point, Smith then included land as a contributor to value (value in exchange) by stating that its rent enters into value and thus into the price of commodities.

Finally, Smith said that the value of land and of capital could be measured in terms of labour, i.e. how much labour these could command in exchange: "Labour is the real measure of the exchangeable value of all commodities." Ricardo differed from Smith on two major points. The first was Smith's inclusion of the rent of land as a contributor to the value of commodities. Later economists, right up to the

present day, support Ricardo in his statement that rent is a surplus over costs of production and therefore cannot enter into unit prices, which are determined at the margin of production.

Ricardo also argued that, since capital is but stored labour, labour is the sole originator of value. This is not easily sustainable when one considers that labour that has been turned into capital (with the use of land!) is no longer labour and can in no way be regarded or treated as such in discussing, in economic terms, the distribution of wealth. This really semantic argument apart, Ricardo came more closely to a logical exposition of the labour theory of value.

John Stuart Mill had little to add to Ricardo's analysis and, while accepting the distinction between value in use and value in exchange, confused this distinction and reintroduced use value back into the theory of value.

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1. *The Science of Political Economy* page 237
2. *Ideas of the Great Economists* George Soule. Mentor Books. New York

CHAPTER 4

Karl Marx on Value

IN VOLUME I of *Das Kapital*[1], Karl Marx sets out his labour theory of value and, although he modifies it in Volume III, it is his first exposition that is generally understood to represent his view despite the significant changes made in Volume III.

In Volume I, Marx argued thus:

Use value, or utility, has no place in political economy: it is exchange value only that has relevance (this follows Adam Smith and Ricardo). Exchange value is a quantitive relation between things. If any given number of things have the same exchange value, then each represents an exchange value replaceable by any of the others. This indicates that there is a factor common and reducible to them all. This factor is labour. After the exclusion of usefulness or utility, commodities "have only one common property left, that of being products of labour." If things are of equal exchange value, this merely means that each contains the same amount of human labour.[2]

There is in Marx's theory the assumption that everything that has value is the product of human labour, that only through labour does value express itself.

In Volume III, Marx argued that the landlord received surplus value from the capitalist as rent, so that rent in fact was part of the surplus value

that the capitalist extracted from the worker because, on land above the margin, workers were able to create a surplus above the average rate of profit.

But Marx's exposition of his theory that value expresses the amount of labour congealed in a commodity leaves many questions unanswered. When Marx discarded use value as being irrelevant, it left only market value and, although the market value of a product reflects to a fair degree the ongoing costs of production (labour and capital), it is by no means dependent upon the original value of the labour that went into it, particularly with products that quickly go out of fashion or, through misplaced optimism, fetch in the market less than was expected or nothing at all. Marx met this objection by explaining that the labour involved in such projects does not count as labour: "Labour spent on anything counts effectively only insofar as it is spent on something that is useful for others." This was the "socially-necessary labour." But scarcity can bring a different (and higher) value than that represented by the labour embodied in it.

Marx deals with skilled and unskilled labour; identical commodities produced with different amounts of labour; the averaging of skills, and other points, some of which are in anticipation of possible objections to his theory. For Marx, all labour is reducible to what he terms "human labour in the abstract."

In the same way, says Marx, that the rent of land is absorbed into the value of raw materials and contributes to total value, so capital (which is only stored-up labour), contributes to the total labour expended on producing the required commodities. Thus, when a cloth manufacturer buys raw materials, machines and labour, each of these items costs the manufacturer the price of the labour that went into them.

If a capitalist paid rent to a landlord, this was regarded as a cost and it reduced the amount of surplus value he could obtain for himself.

Marx said that there were really only two sources of income: labour and surplus value, both of which were created by labour. Wages were paid from the former, and profits and rent were paid from the latter. This theory of surplus value Marx explains thus:

> "The worker produced for his capitalist employer more value than he received in wages. Thus a surplus value arose which was appropriated by the employer in the form of profit."

In describing how this surplus manifested itself, Marx said that the employer did not receive the surplus value as part of the unit price he charged for his goods, but from the additional units produced by the workers in excess of those required to meet his wages. If, for example, six hours working-time per day was sufficient to meet the worker's maintenance (Marx called this the "necessary working time"), then the worker's wage was the equivalent of this. Any extra hours worked in a day (the "surplus working time") was appropriated by the employer, so that, if the worker laboured for ten hours a day, then he was exploited to the extent of four hours a day.

It will be seen that this concept of a surplus arising after costs of production have been met, rather than from an additional profit on each unit produced, is mirrored in Ricardo's theory of rent. Ricardo had, in effect, anticipated a theory of surplus value although he did not describe it as such, and of course arising from a single factor of production - land.

Marx, in his theory of surplus value, makes a distinction between what he terms "constant capital" and "variable capital" and it is from the latter that the whole of the surplus value comes. This variable capital is that part of capital that the capitalist uses to buy labour and make a profit on.

Constant capital is his machinery, tools, etc.

This gives him no return. "Machinery, like every other component of constant capital, creates no new value, but yields up its own value to the product that it serves to beget."[3]

From this it would appear that capitalists would attempt to maximise their labour power and minimise their machinery. And, what of those industries which, in contrast to others, use greater or less proportions of variable capital? Does their rate of profit vary as the rate of variable capital is high or low?

According to this theory, the rate of profit in different industries will vary according to the proportions of variable and constant capital employed in them, and it would, for instance, be folly to replace workers with costly machinery. The replacement of car workers by robots should herald a great diminution of surplus value.

Many critics of Marx raised such objections, and, whilst admitting their validity, Marx did not provide an answer, and the theory that, in Marx's own words, "contradicts all experience" remained.

Marx did promise a solution to this "apparent contradiction" but when the opportunity came in Volume III (the solution did not appear in Volume II) the theory was simply revised to state that profit was calculated on the total capital employed. Marx had eventually come round to a 'cost of production' theory not basically different from Smith's and Ricardo's.

Volume III, incidentally, contains some illuminating chapters on land rent which firmly establish land monopoly as the basis of all exploitation.

We have not dwelt upon all the aspects of value and surplus value (and the refinement of these theories) contained in Marx's writings. For our limited purpose we have only outlined them as representing a *labour* theory of value, the political significance of which will be shown later, for, even if his theory of *surplus* value does not stand up to examination, this

does not necessarily dispose of the labour theory of value itself, the unresolved aspects of which are tackled by Henry George in his *The Science of Political Economy.*

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1. *Capital* Volume I, Chapter 1.
2. Ibid
3. Volume I, Chapter 8.

CHAPTER 5

Henry George on Value

HENRY George, like Professor Perry (1866) whom he quotes, (see Chapter 2) could see that no headway could be made in establishing a sound basis for the study of Political Economy until the words Wealth and Value had precise meanings marking them off clearly from other concepts. Henry George was of course equally concerned with the other basic terms in political economy, but the main confusions could be found in the words wealth and value.

Since the times of Adam Smith and his accredited successors, the lack of definiteness and consistency as to the nature of these terms had, said George, resulted in such confusion that the only proposition that economists appeared to agree upon was that wealth had value. But as to whether all that had value was wealth, there was a wide divergence of opinion. George, along with his predecessors (but more clearly) marks off the distinction between value in exchange and value in use. He avoids, in his exposition, the error of suggesting even the remotest relationship between the two.

Adam Smith, while making the distinction clear, blurred it in the examples he gave, and John Stuart Mill, in attempting to correct Smith, was guilty of the same error himself (see Chapter 3).

While it is true, says George, that the great majority of things have both value in use and value in exchange, the two qualities have absolutely no

connection with each other. The two qualities of use value and exchange value are as essentially different and unrelated as are weight and colour. Value in the economic sense of value in exchange, says George, can never really be intrinsic. It refers not to any property of the thing itself, but to the toil and trouble that men will undergo to acquire possession of it, or the amount of other things costing toil and trouble that they will give for it.

Henry George then takes up the concept of "the value of labour", labour being included by some economists in a category of considered values:

> "What the reputed economists since Smith have called 'the value of labour' is in reality the value of the products of labour paid to labourers in wages."

Thus the ability to labour is not an exchangeable thing and cannot come into any category of values; it resides in the individual body and cannot be taken out of that body and transferred to another.

If you want another man's labour, what you really want is what that labour will produce. You cannot take a man's labour away, wrap it up and store it until you need it. Even if you "own" a slave you cannot really own his labour power - it is not transferable to you - you can only own the *results* of his exertion.

Since value does not exist in labour power, says George, but does appear where that power take tangible form through exertion, the fundamental relation of value must be a relation to exertion and this relation is a *negative* one not a positive one.

Henry George explains:

> "I exchange gold for silver, let us say. In this I give something positively and receive something positively. I get rid of gold and acquire silver. The other party of the exchange gets rid of silver

and acquires gold. But when I exchange gold for exertion or toil, do I get rid of gold and acquire toil, and does he get rid of toil and acquire gold? Clearly not. No one wants exertion or toil; all of us want to get rid of it. It is not exertion in a positive sense which is the object of the exchange, but exertion in a negative sense; not exertion given or imposed but exertion avoided or saved; or, to use the algebraic form, the relation of the quality of value is not to plus-exertion, but to minus-exertion. Value, in short, is equivalent to the amount of toil which the possession of that thing will save the possessor, or enable him, to use Adam Smith's phrase, 'to impose upon other people' through exchange. Thus, it is not exchangeability that gives value; but value that gives exchangeability."

In short, says Henry George, contrary to the current theory that it is when and because a thing becomes exchangeable that it becomes valuable, it is when and because a thing becomes valuable that it becomes exchangeable. It is not the toil and trouble which a thing *has* cost that gives it value. It is the toil and trouble, or its equivalent, that others are *now* willing, directly or indirectly, to relieve its owner of in order to possess that thing.

Whether a diamond is merely picked up or obtained after years of hard toil has nothing whatever to do with its value. That depends upon what others are willing to give for it. That which may be had without toil and trouble, continues George, has no value. There is no measure of value among men save competition or the higgling of the market.

Thus George resolves his theory basically into a curent or future cost-of-production theory:

"We speak properly of the value of certain things as being determined by the cost of production. But the cost of production that we thus refer to is not

what the thing itself has cost, but what such a thing would cost now."

Following on Smith, Ricardo and Marx and various other economists of note, George ruled out use value as having any place in political economy. Further, he clarified the relation of labour to exchange value, rebuilding the labour theory of value *as it applied to man's products*.

But man's products are not the only things that have exchange value. To what then, are these other things related? Or to put it another way, what is their source of value?

It is here that Henry George divides value in exchange into value arising from production and value arising from obligation, *a division of the greatest significance and one ignored by all other economists*.

This opens up a new area of the analysis of value and it is appropriate at this point to see 'how political influences have been instrumental in the virtual abandonment of all labour theories of value and their replacement by the marginal utility theory.

Some interesting observations on political influences in economics are given by Edwin R. Seligman[1] in an article in the *Economic Journal*. Among the subjects covered by these "Neglected British Economists" are: the opposition to the labour theory of exchange; the broadening of the rent concept; and the theory of marginal utility as a basis of value.

Seligman says:

"But, it will be asked, how does it happen that all these authors have been so largely overlooked and neglected? For very much the same reason that Cournot was passed over in France, and Gossen in Germany. Their views were not in accord with those of the dominant school. The practical issues of the time were so momentous that the economic science which taught a doctrine in harmony with

these practical demands was accepted as infallible .... but when the demands of the dominant social and political classes were rienforced by the teachings of the scientists, economics leapt with a bound into the position, not only of a popular, but almost a sacrosanct science.... The reputation of the great names was such that any deviation from accepted doctrine was banned as unorthodox."

It must be remembered of course that orthodoxy is not always wrong! Whether we would agree with criticisms of so-called orthodox economic thinking or not, many disputes are based on political rather than economic thinking. We must not only beware of being misled by *political* economics, we must also guard against being guilty of its ourselves. All theories must stand the test of reasoning and accuracy of facts.

Seligman in his article examines the economids of Samuel Read (1829) and says:

"Read's opposition to Ricardo is shown in many ways. He criticises unreservedly the statement that labour is the sole cause of wealth. He considers this 'a most mischievous and fundamental error', mischievous largely because of the conclusions that have to be drawn from the principle by the 'labour writers'."

But Seligman himself is not above pinning a socialist tag on Ricardo for he continues:

"Read is the first thinker clearly to perceive that through this theory of value the Ricardian economics leads logically to Ricardian socialism."

There can be no doubt that the rejection of the labour theory of value was politically convenient, and those who rejected it were not slow themselves in accusing its supporters of adherence to it for

political reasons. In *A Textbook of Economics* J.L. Hanson, to whom we have already referred, says:

> "It is not surprising that the labour theory of value was eagerly seized upon by writers seeking support for pre-conceived political views. Karl Marx and his followers reiterated the view that the value of a commodity depended on the amount of labour required for its production in order to be able to assert that the worker was entitled to the entire fruit of his labour."

Not content to dismiss the association of labour with value, Hanson goes on to say:

> "The cost-of-production theory of value is merely a refinement of the labour theory of value."

Note the pejorative use of the word 'merely'.

Despite certain weaknesses in the labour theory of value as expounded by early economists, there was no reason for damning it completely and substituting the highly dubious marginal utility theory of value. Henry George's development of the labour theory of value and his original contribution to the value theory is ignored. Henry George was not a socialist – but perhaps he was regarded as something more dangerous.

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1. *On Some Neglected British Economists, Economic Journal*, Volume XIII, 1903

CHAPTER 6

The Marginal Utility Theory of Value

ALTHOUGH often spoken of as the product of the Austrian economists, the marginal utility theory of value is apparently English in origin, the Rev. W.F. Lloyd having advanced the basis of the theory in a little known lecture delivered at the University of Oxford in 1833 and published in 1834. William Stanley Jevons (1835-1852) is considered to have arrived at the theory independently of either Lloyd or the so-called Austrian school. While a number of other economists have contributed to the theory, adding their own refinements and ideas, its essence is this:

> Use value or utility is the key to value - not labour or costs of production. Value has its origin in the mind of a person seeking to assess the worth of a useful article. This value finds its level at the margin, the margin being represented by the utility to be found in the last portion of successive portions having diminishing utility because satisfaction decreases with every available additional portion. Expressed another way, the margin is the point at which the least important use is to be derived from an article subject to the amount available.
>
> Finally, this value is reflected back from the

consumer goods to the agents which have produced them, so that value deterines costs, not the other way round. A common illustration of the process by which the marginal utility of an article is finally arrived at is as follows:

> A hungry man will value highly a loaf of bread. He will value a second loaf, but less than the first. A third loaf will give even less satisfaction to him, and so on until he reaches a point where the cost of acquiring a further loaf gives him more 'pain' than 'pleasure' in eating the loaf. The last loaf he buys is the marginal loaf and this fixes the limit of his demand.

Although bread is not actually bought in this fashion, the price getting lower each time he buys another loaf, it is the marginal loaf that determines the price of all loaves.

This calculation on the part of the buyer is applied to all the goods he buys. But since most, if not all, people cannot buy everything they want, the consumer apportions his spending in accordance with the relative marginal utility to himself of each article.

The theory covers capital goods as well as consumer goods – the buyer or exchanger weighing the satisfaction he gets from what he buys with whatever he parts with. It is the sum of all these influences which finally determines price in the market.

Both Jevons and Leon Walras were mathematicians and expressed their theories of marginal utility in complex (to laymen at least) mathematical form.

Summarised below are just some of the aspects of marginal utility (other than those already outlined) expounded by the Austrian writers, although these ideas are not necessarily exclusive to them.

Auguste Walras (1801-1866)

If utility explains value, then where there is

utility there also is value. But water and air have utility but no value. This difficulty is overcome by bringing in scarcity - only scarce things can be considered as wealth, or those things in limited supply. Whatever value such things have is due to this limitation.

Hermann H. Gossen (1810-1858)

The satisfaction or utility that any commodity gives is modified by its cost of production. So there is a point where satisfaction and cost of production equate; utility and disutility are balanced. When there exists a choice between several enjoyments, but not time to enjoy them all, each should be enjoyed to the point where an alternative enjoyment gives most satisfaction. At the breaking-off point the two separate enjoyments equate in satisfaction. Gossen's expositions were accompanied by mathematical symbols or numbers and his book is described by Alexander Gray (Development of Economic Doctrine) as "repellently mathematical and chaotic". It was "one of those books that are made not to be read" (and it rarely was).

Karl Menger (1840-1921)

Value is the utility possessed by goods, exchange is merely external evidence of what is in the mind of the evaluator. Value is entirely subjective. Menger ignored entirely objective considerations of value. Goods are classified as being of the first order, second order, third order, etc., according, it would appear, to the order in which they come in the chain of production. Bread would be of the first order as it can immediately satisfy a desire; flour is of the second order; the flour mill of the third order and so on, presumably a series of orders right back to the plough in the field. If goods went out of fashion or were not required, then the goods of the higher orders previously used in making them would not be considered any further as goods - unless they

could be used in any other capacity. Reversely, pens would cease to be goods if ink were unobtainable, etc. There are more elaborations and refinements to Menger's theory which weary the mind.

Friedrich von Wiesen (1851-1926)

Value is the basis of all economic theory. The function of the state is the maximising of values. Cost of production is the payment necessary to justify use of particular productive resources as being more desirable than some alternative use and it is marginal utility that decides that. In the process of working out his theory, Wiesen appears to be attempting a reconciliation of it with the cost-of-production theory of value.

Eugen von Böhn-Bawerk (1851-1914)

This contributor to the marginal utility school followed more or less the same lines as the others. He did however develop the theory of what he calls "marginal pairs". The determination of price by the so-called "marginal pairs" is novel only in its exposition and setting. Otherwise, it might be described as a "blinding glimpse of the obvious". No man will pay more and no man will accept less than he thinks an object is worth. The price will thus fall between these limits if an exchange takes place. Further, in an auction, the buyer will be the person who offers most and he must outbid the limit set by the bidder who, next to him, hangs on longest. Böhn-Bawerk then illustrates his "marginal pairs". There are ten people who want to buy a horse in the market and eight people who want to sell one. All horses are alike. Each person has his own idea of what a horse is worth. Then there follows in the illustration a chart showing a variety of valuations ranging from £10 to £30.

Although in isolation the price will fall between £10 and £30, the conflicting estimates of value

between buyers and sellers, buyers and buyers, and sellers and sellers, result in the final price being arrived at by reference to the particular pair of marginal buyers and sellers whose private estimates come closest to each other.

It would appear that the participants in this highly improbable situation are not consciously aware of Böhn-Bawerk's theory. However, they put an exchange value on their own subjective estimate - and leave the rest to the market!

(What of other markets elsewhere, the coincidence of horses having the same value and the wide range of subjective estimates of value?)

Some interesting questions arise from the whole theory of marginal utility as it is applied to market value and therefore price.

We have already given George Soule's assessment in his *Ideas of the Great Economists* (1952) in Chapter 3 in which he asks "How relevant is it to the real world? What can you do with a theory like this?" And he finishes his comment by shrewdly observing that the theory is little more than an impressive elaboration of Adam Smith's "invisible hand", all forces, interests, incentives, preferences, costs, etc., coming together unconsciously in the market place. In short, no man will pay more for an article than he is obliged to - despite his subjective estimates of worth. And of course the same principle applies to the seller, the other way round.

Peter F. Drucker, to whom reference has already been made, says in his article *Towards the Next Economics* (1980) "... But as an economic world view, or as an economic system, the earlier theories - such as the disciplined orthodoxy of the Austrian school of economics, which was popular in the early 1900's - will not do."

Drucker later takes the usual attitude of Marx's critics towards Marx's labour theory of value. "Karl Marx and the Marxists refused to abandon the Labour

Theory of Value. This then forced them to spurn economic analysis" (presumably of the Austrian variety).

This seems a little unfair on Marx for, however faulty his initial economic reasoning in his labour theory, this does not dispose of the labour theory *per se*.

Drucker himself obliquely supports a labour theory of value. He says:

> "The next economics should again have a theory of value. It may base itself on the postulate that productivity - that is knowledge applied to resources through human work - is the source of all economic value.
>
> "Productivity as the source of value is both *a priori* and operational, and this satisfies the specifications for a first principle."

Does this mean that we are to have a labour theory of value in new clothes, disguised, as it were, to make it acceptable to non-Marxists?

Keynes was purported to have been asked why his *General Theory* contained no theory of value. To which he replied, "Because the only available theory of value is the labour theory and it is totally discredited."

Drucker comments:

> "None of the great non-Marxist economists of the last hundred years, Alfred Marshall, Joseph Schumpeter, or John Maynard Keynes, was in turn comfortable with an economics that lacked a theory of value altogether. But, as the Keynes anecdote illustrates, they saw no alternative."

It is interesting to observe that, if Ricardo's elimination of rent as a factor of price and his classification of capital as stored-up labour is accepted, then one has a cost-of-production theory of

value (all other overheads being classified as forms of labour).
Does this differ from Drucker's final words?

"Productivity as the source of all economic value would serve .... Productivity is both man and things, both structural and analytical. A productivity-based economics might thus become what all the great ecomomists have striven for ..."

Henry George (from *The Science of Political Economy*)
The more ingenious and elaborate the attempts that have been made to give something like solid support and logical coherency to the prevailing theory that value is really nothing more than exchangeability only the more clearly show its utter inadequacy. Thus the latest and most elaborate of these attempts, that of the Austrian or psychological school, which derives value from what it calls "marginal utilities", is an attempt to emulate in economic reasoning the stories told of East Indian jugglers who, throwing a ball of thread into the air, pull up by it a stouter thread, then a rope, and finally a ladder, on which they ascend until out of sight, and then – come down again!
For whoever will work his way through the perplexities of their reasoning will find the adherents of this school derive the value of pig-iron, for instance, or even of iron ore in the vein, from the willingness of consumers to pay for higher and more elaborate products into the production of which iron enters, deriving that willingness from a mental estimate on the part of consumers of the utility of these products to them. Thus, as coolly as such stories of Indian jugglers ignore the law of gravitation, do they ignore that law which to political economy is what gravitation is to physics, the law that men seek to satisfy their desires with the least exertion – a law from which proceeds the universal fact that as a matter of exchange no one will pay

more for anything than he is obliged to.

These elaborate attempts to link value on utility, and the utility on individual will or perception, in order to find a support for the idea of value, only show that there is no resting-place in the supposition that value proceeds from exchangeability, and can only be relative to other values.

Thus, that value depends on value, and springs from value and can only be measured by value - that is, by the selection of some particular article having value, from which relatively and empirically the value of other articles may be measured - seems to us perfectly clear, and we accept the doctrine that there can be no general increase or decrease in values, as if it were but another statement of the axiom that a whole is equal to the sum of its parts, and consequently that *all* those parts can never be increased or diminished at the same time.

The habitual use of money as a common measure of value is apt to prevent any realisation of the fact that we are reasoning in a circle.

I think I have correctly described the line of reasoning which makes the derivation of value from exchangeability so plausible. I do not of course mean to say that labour is never taken into account. It is often expressly mentioned and always implied to be one of the valuable things. But the weight of the examination is, I think, always thrown upon such things as I have named - things resulting from the exertion of labour; while labour itself is passed over lightly as one of the "other valuable things", and attention never rests upon it.

Imagine a ship containing such merchandise as would tempt the fancy of a primitive people to come in sight of an island and cast anchor. Would exchange between the ship's people and the islanders be impossible because of the lack on the part of the islanders of anything having value? By no means. If nothing else would suffice, the offer of bright cloths and looking-glasses would surely tempt the

Eves, if it did not the Adams; and though never exerted before, the islanders would exert their power of labour to fill the ship with fruit or nuts or shells, or whatever else of the natural products of the island their exertion could procure, or to pull her on the beach so that she might be calked, or to fill and roll her water-casks. There was nothing of value in the island before the ship came. Yet the exchanges that would thus take place would be the giving of value in return for value; for on the part of the islanders value that did not exist before would be brought into existence by the conversion of their labour power through exertion into wealth or services. There would thus be what so many of our economists say is impossible, a general increase in values. Even if we suppose the islanders to relapse into their former easy way of living when their visitors sailed off, there would still remain on the island, where there was no value before, some things having value, and this value would attach to these things until they were destroyed or so long as such desire as would prompt any of the islanders to render labour in exchange for what remained.

Nothing, indeed, can be clearer than this. Even in the richest of civilised countries, the ultimate purchasers of the greatest mass of valuable things, are not those who have in store valuable things that they can give in exchange. The great body of the people in any civilised society consists of what we call the working-class, who live almost literally from hand to mouth, and who having in their possession at any one time little, or practically nothing, of value. Yet they are the purchasers of the great body of articles of value. Where does the value which they thus exchange for value which is already in concrete form come from? Does it not come from the conversion of their labour power, through exertion, into value? Is not the exchange which is constantly going on, the exchange of the potentiality of labour, or *raw* labour power for labour power that by that transfer has

already been converted into value? In common phrase, they exchange their labour for commodities.

How does this fact consort with the theory that value is a relation of exchangeability between valuable things, and that there can be no general increase or decrease of values? Does it not utterly invalidate the theory? Must there not be a constant increase of value to make up for the constant destruction of value, and in spite of it, to permit such a growth of aggregate values as we are going on in progressive countries?

Value has of course its origin in the feeling of desire. But the only measure of desire it can afford is akin to the rough and ready way of measuring sorrow which was proposed at a funeral by the man who said:

> "I am sorry for the widow to the amount of five dollars. How much are the rest of you sorry?"

Now, what value determines is not how much a thing is desired, but how much anyone is willing to give for it: not desire in itself, but what the elder economists have called effective demand - that is to say, the desire to possess, accompanied by the ability and willingness to give in return.

Thus it is that there is no measure of value among men save competition or the higgling of the market, a matter that might be worth the consideration of those amiable reformers who so lightly proposed to abolish competition.

CHAPTER 7

Value: A Summary and the Two Sources of Value

WE ARE now able to review the value controversy and decide whether we can support a particular theory or reach an eclectic conclusion or evolve our own.

Before endeavouring to establish what determines market value, let us first establish what does not.

We have seen that Smith, Ricardo, Mill, Marx and George rejected the subjective sense of value expressed in such terms as "use value", "utility", "usefulness", etc., as having no relevance in political economy.

Exchange, the lifeblood of any community, springs from the division of labour without which no community could for long enjoy more than a primitive existence. As the division of labour and thus specialisation involves exchange, it is exchange value with which political economy is concerned. We have now two questions to answer:

(1) What makes an article valuable?
(2) What determines what that value is?

Confining ourselves to man's products for the moment, as indeed did the classical economists and those who followed, we establish that, although a labour theory provides the answer to (1), it fails to answer (2) since, by the time products have reached the market (which is not necessarily immediately they have been made), many of which had the same amount of labour expended on them, have different values in

exchange. The only possible answer to (2) – what is it that determines value? – is the market place itself. If we still wish to relate market value to labour, then the only way this can be done is to follow Henry George and observe that it is not the exertion, toil or trouble that goes into an article that determines its value but the toil and trouble that a person will undergo in order to possess it, or conversely the toil and trouble that it saves a man by possessing it. The answer is still in the market place. The subjective estimates of buyers may still be present in bargaining but this will determine not value but *only whether a person is willing to buy or sell.* Buyers or sellers cannot force the market to adopt their own estimates of value.

Now let us go back a little to the point made by the classical economists that capital is but stored-up labour. The point is well made that a finished article contains the labour of the men who made the capital as well as that of those who used the capital as tools. But this is a philosophical observation not an economic one. The study of political economy is the study of the production of wealth and its distribution among the separate factors engaged in production, of which capital is one. A physicist would agree that ice, water and steam are really only different forms of H_2O, but would insist that by the very nature of his studies, he must recognise their differences and treat them as different substances. Thus in the science of political economy, capital stands as an independent factor of production and an independent contributor to the finished product.

The question of whether land is a contributor to the value of an article was another controversial point in the discussions of the classical economists. That land is a factor in production, and thus a contributor to the value of the final product, appears to be self-evident if we are thinking of the physical properties of land and, philosophically, of the use value of land. However, in economics we cannot

regard land as contributing to the exchange value of a commodity. Land above the margin that is used in production produces a surplus which is accounted for by rent and does not enter into unit values.

Imagine an abundance of land of equal fertility which could be had without the payment of rent. What will determine the exchange value of products made from that land? Is it not the case that the land, being basic to all the activities of labour, would be ignored in calculating costs of production? Men meeting to exchange their products would barter on the basis of labour for labour and however this was modified by the free market, they would do so without reference to the land used, for this would be a factor that would give equal advantage to all producers.

Thus we may conclude that, although the value of the final product is modified by competition, temporary monopoly or scarcity, land, in strictly economic terms, would not be a factor that entered into the value of the final product. Our example equates with what takes place on marginal land, and to those paying rent, whether much or little; they are effectively working on marginal land. It is this approach that leads us to agree with Ricardo that rent does not enter into the value of commodities sold on the market. This leaves only labour and capital (and all other "overheads" involved which are essentially labour and capital) to contribute to exchange value which finds it ultimate level in the market and these two factors are normally expressed as costs of production.

While the vagaries of the market must always prevail, it is nonetheless interesting to observe that when there is a constant stream of goods flowing from manufacturer to consumer, costs of production as defined are reflected pretty accurately in the shelf values of goods offered for sale. Slow selling goods are not necessarily marked down in price but rather the quantity offered for sale reduced. But it

requires little to upset the basic relationship between cost price and selling price as any businessman will testify – the market reigns supreme.

In this brief survey of the ideas behind the labour theory of value, we arrive at Henry George's theory that value is related *negatively* to labour. This theory has a double significance. First it overcomes the problem faced by the classical economists of reconciling original labour costs with ultimate market values, and secondly it rectifies the omission from the labour theory of those values that arise from obligation (they could not be accommodated without being represented as a form of labour).

Values arising from obligation, of which land is the dominant one, do not have labour embodied in them. But George's theory requires not that labour be embodied in products but that labour can be *commanded* by products. The possession of land can command the labour of others directly or indirectly. Land has value for this reason.

Thus George's theory of value is the only logical one. But why has it not been recognised even to this day? It is because a labour theory of value has become politically unacceptable and its replacement by the subjective theory of marginal utility has effectively barred the way to further investigation that would have lead, first, to a logical explanation of value, and then to water-tight definition of wealth confined to values that arise from production only.

But this would have invited a separate ethical judgment as to the rights of property in the products of man and right of property in land. Is there any other explanation for the failure to define wealth right up to this day?

The Two Sources of Value

(Abridged from Henry George's *The Science of Political Economy*)

It is usually, if not invariably, assumed in all standard economic works that the conversion of labour-power through exertion into services or wealth is the only way in which value originates. Yet what we have already seen is enough to show us that this cannot be so.

It is not the exertion that a thing has cost, in past time, that gives it value, but the exertion that its possession will in future time dispense with, for even the immediate is in strictness future. Thus value may be created by mere agreement to render exertion, or by the imposition of such obstacles to the satisfaction of desire as will necessitate a greater exertion for the attainment of the satisfaction. In the same way, the value of some things may be increased, or sometime perhaps reduced, without the production of real wealth; or even by the destruction of real wealth.

A government or joint stock company may issue obligations in the form of bonds or stock, which may at once assume a value dependent as in the case of an individual upon the strength of the belief that the obligation will be faithfully redeemed.

There is in all this no increase of wealth; but there is a creation of value - a value arising out of obligation and dependent entirely upon expectation but still a value - an exchangeable quantity, the possession of which could command through exchange other valuable things.

Whether an individual has the power of commanding exertion from others because he has added to the general stock, or simply because he holds the power of demanding exertion from others makes no difference to him or to them. In either case he gets and they give.

But in political economy, which is the economy of

society, there is a great difference. Value of one kind - the value which constitutes an addition to the common stock - involves an addition to the wealth of the community, and thus is wealth in the politico-economic sense. Value of the other kind - the value which consists merely of the power of one individual to demand exertion from another individual - adds nothing to the common stock; all it effects is a new distribution of what already exists in the common stock, and in the politico-economic sense, is not wealth at all.

In the development of political economy from Adam Smith, these two totally different kinds of values have been confused in one word. Smith started by recognising as value that which added to wealth, but he afterwards, and with seeming carelessness included as value that which adds to the wealth of the individual, but adds nothing whatever to the wealth of the community. This consorted with the common idea that the wealth of a community is the sum of the wealth of individuals, and enabled all that has value to the individual to be included as politico-economic wealth.

But it was impossible to treat as one and the same quality a value that added to the wealth of the community and a value that did not, and yet to make an economic definition of wealth. This therefore has been the point on which the political economy founded by Adam Smith has been constantly at sea. it could not be political economy until it had defined wealth, and *it could not define wealth until it had recognised this distinction between two kinds of value.*

This difficulty might have been avoided in the beginning by giving to the two kinds of value separate names, but the word value has so long been used for both, that the best a science of political economy can do now is to distinguish between value of the one kind and value of the other kind.

This however it is necessary to attempt. The best thing I can do is to distinguish value, not as one,

but of two kinds.

By a clear distinction, the various ways in which value may originate, embrace (1) the value which comes from the exertion of labour in such a way as to save future exertion in obtaining the satisfaction of desire; and, (2) the value which comes from the acquisition of power on the part of some men to command or compel exertion on the part of others.

Value arising in the first mode may be distinguished as "value from production", and value arising in the second mode may be distinguished as "value from obligation" - for the word obligation is the best word I can think of to express everything which may require the rendering of exertion without the return of exertion.

But while making this distinction it must be remembered that the essential character of value is always that of equivalence to exertion in the satisfaction of desire. This is not necessarily the toil and trouble which the purchaser will agree in his own person to undergo, but the toil and trouble which he had the power to command or to induce others to undergo.

Among the valuable assets of the large land-holders of feudal times was the right of holding markets, succeeding in certain instances to the property of tenants; or of grinding grain, of coining money, of collecting floatwood, etc. The values of these were clearly "values from obligation". But that they have passed insensibly into the single right of exacting a rent for the use of land is proof that the value of this right - the right, as it is called, of private ownership of land - is in reality a "value from obligation".

The most important of additions to value which do not increase wealth are unquestionably to be found in land value, the form of value from obligation which in the progress of mankind to civilisation tends most rapidly to increase. Land value is not part of wealth in the economic sense. It can have, so far as

the individual is concerned, none of the moral sanctions of property. It rightfully belongs to no individual or individuals but to the community itself.

And this is the reason that neither by Adam Smith nor by those who succeeded him has the true character and dual nature of value been realised. For to recognise that is to come to the conclusion of the Physiocrats that, in the economic sense, land is not wealth. And this involves a revolution, albeit to society a beneficent revolution.

Whatever increases the obstacles, natural or artificial, to the gratification of desire on the part of the ultimate users or consumers of things, thus compelling them to expend more exertion or undergo more toil and trouble to obtain those things, increases their value; whatever lessens the exertion that must be expended or the toil and trouble that must be undergone, decreases value. Thus, wars, tariffs, pirates, public insecurity, monopolies, taxes and restrictions of all kinds, which render more difficult the satisfaction of the desire for certain things, increase their value, and discoveries, inventions and improvements which lessen the exertion required for bringing things to the satisfaction of desire, lessen their value.

Here we may see at once the clear solution of a question which has perplexed and still perplexes many minds - the question whether the artificial increase of values by governmental restriction is or is not in the interest of the community. Scarcity may be at times to the relative interests of the few, but abundance is always to the general interest.

CHAPTER 8

The Corruption of Terms

WE HAVE noted the still unresolved ambiguity in the use of the words value and wealth.

It is not our task to put our own labels on economic concepts. The terms are there and have been in use in political economy since before the time of Adam Smith. Our task is to grasp the specific ideas behind these terms and note their mutual exclusiveness *as concepts*. Each concept must then be matched to its related economic term *with the same exclusiveness*.

Land

We can begin by observing the distinction between the natural elements of the earth and man himself. This can be brought clearly to mind by a mental picture of man entering new territory for the first time. To this concept of natural resources, economists have given the term land.

Despite the clarity of this concept, which excludes man and his products, many economists have confused it by introducing the idea of "made land" (really "drained land") thus obscuring the unique characteristics of land.

Other economists, while agreeing in principle to the distinction between land and the work of man's hands, nonetheless render the distinction of little consequence by maintaining that in practice there is

no clear dividing line between land and improvements to land. But for the purpose of political economy it is not necessary that land and improvements to land be *physically* separated, particularly as valuers regard the separate valuation of land as a routine part of their professional work – whether the land is vacant or has a building standing upon it.

Some further confusion on the subject is shown by John W. McConnell who, in his *Ideas of the Great Economists*[1] (not the George Soule book of the same title), says (page 44):

> "... these later writers held that it was impossible to separate the return due to the land itself and the return on the capital investment made on the land .... Old ideas of the limited amount of land and its indestructibility which at first were considered sufficient reason for discussing rents as a separate and unique economic factor have been proved untenable. Land is no more limited than machinery since both are derived from the substance of the earth, and the fertility of the soil, as well as the soil itself, can be destroyed."

These "later writers" include Karl Menger and Alfred Marshall and it is not surprising that these economists, among others, sought to confuse the issue further by arguing that rent was not peculiar to land but applied also to capital and labour. But more of rent later.

Now, whether one "makes" land by fencing off the sea and draining swamps, or "destroys" land by injudicious use so that the top soil is washed away, this has no effect upon the land elsewhere which must at least remain subject to economic laws. But the non-sequiturs, unsupported claims and tortuous logic (the earth is derived from the earth!) indicate the length to which some economists will go to obscure the nature of land and its rent.

Labour

For the contribution that man makes to production through his mental and physical energies, the accepted term is labour. Even so, some economists have sought to establish a certain kind of labour (management) as a separate factor of production. Usually called the entrepreneur, this so-called factor is supposed to participate separately in the distribution of wealth, receiving "profits", while the other three factors receive rent, interest and wages.

But this term "profits" has had to serve many purposes, being used to describe not only compensation for risk, but the return to monopolies and to the other factors individually or collectively according to the whim of the writer. This may not matter in accountancy or in everyday speech, but it will not do for economic analysis.

One can see the immediate difficulties that arise when one talks of "taxing profits", "excess profits", "profit sharing" and the "profit motive". The word profit is used too widely for it to have any useful function in economic analysis, yet it persists, and serves only to add to the general confusion in economic thought.

Wealth

Man's products have already been mentioned and no clearer concept of just what these are could be found than that expressed by these words. Yet when we come to the word wealth, used since the time of the earliest economists to describe man's products (or goods or commodities, which express the same meaning), confusion immediately appears.

It is not that there is any difficulty in using the term wealth as an economic term to describe the products of man. The confusion arises when the term is used to embrace things that are *not* the products of man, as we have so clearly seen.

We shall return to the subject of wealth later as a

conclusion to our study of value. Meanwhile let us look at the definition of wealth given in the authoritative *Everyman's Dictionary of Economics* (1976)[2] by Arthur Seldon (Editorial Director Institute of Economic Affairs and formerly Examiner in Economics, University of London) and F.G. Pennance (late Professor of Land Economy, University of Aberdeen).

Wealth, according to the entry under this heading, is "commodities (and claims to services) that are capable of satisfying wants". This is the first extension of the term beyond the products of man. Then we are told that included in the collective wealth are "fuel services", mines, schools, hospitals, etc., with no indication whether the land element in these items is excluded. Homes are included in private wealth with again no exclusion, stated or implied, of the land element.

Yet under the entry "Land" we are told that the term includes mineral deposits, whereas "mines" are included in the definition of wealth!

It is not surprising that under the heading of "Tax, Shifting and Incidence" we learn that, although a site-value tax cannot be passed on, (or rather that the theory of economic rent "suggests" that this tax cannot be passed on), it is not the ideal tax claimed by its advocates, because of the difficulty of separating buildings from land and the dangers of penalising improvements and thus discouraging them!

Capital

For those products of man produced not to satisfy desires directly but indirectly, by using them as tools to aid in the production of more goods, the term "capital" emerged. Thus, although all capital was recognised as wealth, it could be observed that not all wealth was capital.

Adam Smith in his *Wealth of Nations* defined capital as that part of a man's stock which he expects to yield him a revenue, and included in "stock" not only

tools and machines but also stock-in-trade, provisions and wealth in the process of production. This was generally accepted, but once again those things which are clearly *not* part of the concept of capital, but part of the concept of *land*, have been included under the term capital by the majority of modern economists.

Thus "land" has become "capital", the reasoning apparently being that because two things have something in common (they could be both regarded as assets or as having exchangeable value) therefore they are the same thing.

From this sleight of mind, whatever applies to capital proper applies also to land. Once again the original character of land is obscured, and the private ownership of capital extended to justify the private ownership of land.

Thus is the clarity of thought behind the concepts distorted by the corrupted use of the terms applied to them.

If we turn again to *Everyman's Dictionary of Economics*, we see that confusion persists. Capital "in economic theory is the stock of resources available to help satisfy future wants" and "a community's stock of material wealth". And then, to make things "clearer", we get this: "Society's stock of man-made material wealth, plus net claims on people in other countries, is *the most inclusive concept*".

Of non man-made goods or immaterial goods nothing is said! The tautology of "man-made" and "material" as applied to goods seems necessary to the authors in order to enable them to avoid saying directly that capital consists of all things that are wealth, when clearly they are not.

Finally we are told that titles to property form part of personal capital and that it is usual to exclude household stocks from capital, partly because they are "difficult to value".

If we clear our minds of all this confusion and return to the separate and finite concepts behind the

economic terms first used to describe the production and distribution of wealth, we can now match the terms most suited by usage and logic to these concepts, remembering to keep the terms as separate as the concepts themselves: Land (all natural resources outside of man and his products), Labour (man's physical and mental efforts directed towards the production of wealth) and Capital (both wealth used for the production of further wealth and wealth in the course of production). We can then proceed to examine the terms used to describe the channels of distribution through which the wealth produced by these factors naturally flows.

Early economists designated these terms Rent (for land), Wages (for labour) and Interest (for capital) with only a minor ambiguity, which was resolved with clarity by Henry George in *Progress & Poverty*.

Wages

This term gives little trouble despite its subdivision into salaries, fees, commissions, etc. The concept is still held.

Interest

The original meaning of the term - the return to the factor capital - has not been entirely lost, despite the highly ambiguous term profits being used as a substitute and the fact that the word interest is now used more frequently to describe the cost of borrowing money than the earnings of capital in business.

Rent

At this point we need a more detailed study of the term. It has been robbed of its exclusive economic meaning as applying only to land and broadened to include concepts which have nothing to do with land. The classical economists used the term without any ambiguity, being careful always to point out the composite meaning of the word when applied to the

rent of buildings or farms, etc., distinguishing land from improvements on it. They noted also that rent arose whether it was received by a landowner for the use of his land or enjoyed directly by him in his own use of the land. Although the term "rent" was frequently used interchangeably with the words "economic rent" or "land rent", the concept was never lost sight of.

The word rent has now been annexed for another use and although it includes the original meaning of rent-of-land, it now embraces the "rent" of other factors as well, effectively diverting discussions on rent proper by arguing in effect that, since there is nothing unique about land rent, there is nothing unique about land.

Rent will be the subject of the next chapter.

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1. Barnes & Noble Books, New York.
2. Published by the Institute of Economic Affairs, London.

CHAPTER 9

Rent

IT MATTERS little how the concept of rent (of land) was first formulated but up to the time of Henry George its exposition was virtually confined to agricultural land. Sir William Petty, a seventeenth-century English economist, appears to have been the first to expound the nature of rent.

William Petty (1623–1687)

Petty saw land rent as a surplus arising after the costs of producing crops or raising livestock had been met.

> "Suppose a man could with his own hands plant a certain scape of land with Corn, that is, could Digg or Plough, Harrow, Weed, Reap, Carry Home, Thresh and Winnow so much as the husbandry of this land requires; and has withal Seed wherewith to sowe the same, I say, that when this man hath subducted his seed out of the proceed of his Harvest, and also, what himself has both eaten and given to others in exchange for Clothes and other Natural necessaries; that the remainder of Corn is the natural and true Rent of the Land for that year ..."[1]

Petty saw that rent arose not only from differences in fertility but from the relative distances of

cultivated land from the centres of population (A Treatise on Taxation and Rent 1662).

The capitalisation of rent into a purchase price for land was also observed by Petty. Further, he knew the relation of population to rent, for in his *Treatise on Ireland*[2] 1687, he suggested that the religious conflicts in Ireland could be resolved by forcibly transporting one million Roman Catholics to England and Wales. The effect, says Petty, would be to raise rents there.

> "If the Rent of Lands of England and Wales be 11 millions, when People are but 7 millions, then the addition of another Million will make the rents one seventh Part more than now, and the Number of Years Purchase will be one seventh more also."

John Locke (1632-1704)

Locke attributed the productivity of land more to the work of man than to nature: "Nature and the earth furnished only the almost worthless materials as in themselves ..." This foreshadows the often accepted idea today that land has no value until labour (and capital) is used on it, confusing of course, value-in-use with value-in-exchange. Land rent was regarded by Locke as the return on the investment put into land for its improvement so as to bring it to a state of cultivation. This idea was adopted by other economists (chiefly mercantilists) and led to the practice, prevalent to this day among some economists, of treating land as but a form of capital. Rent, or at least part of it, was acknowledged as arising from natural fertility.

Anne Robert Jacques Turgot (1727-1781)

In his *Reflections on the Formation and Distribution of Riches* (1770) Turgot, who best represents the views of the Physiocrats or the *Economistes*, identifies rent as the surplus derived from the use of land after basic costs have been met.

Rent is affected by the price of produce, fertility of the soil and competition among farmers for land.

Adam Smith (1723-1790)

Smith's ideas on rent were essentially the same as Petty's and Turgot's. Rent was a surplus – an unearned surplus. This surplus, said Smith, was appropriated by landlords through the exercise of their monopoly of land and was represented by the surplus that arose after the basic costs of production had been met.

Smith said that rent entered into the prices of commodities,[3] a theory later to be challenged by Ricardo. Smith, however, recognised location as well as fertility as a factor from which rent arose.

> "The rent of land not only varies with the fertility, whatever be its produce, but with its situation whatever be its fertility. Land in the neighbourhood of a town gives a greater rent than land equally fertile in a distant part of the country. Though it may cost no more labour to cultivate one than the other, it must always cost more to bring the produce of the distant land to market."[4]

Despite the preoccupation with agricultural land by Smith (and later Ricardo), there was an awareness that non-agricultural land produced a rent and coal, silver and other mines are discussed briefly in this context.

> "A good stone quarry in the neighbourhood of London would afford a considerable rent .... The paving of the streets of London has enabled the owners of some barren rocks on the coast of Scotland to draw rent from what never afforded any before."[5]

Kelp, a species of seaweed useful for making glass, soap, etc., which grows particularly in Scotland and

which twice every day is covered by the sea and was never augmented by human labour, is a source of rent:

> The landlord whose estate is bounded by a kelp shore of this kind, demands a rent for it as much as for his corn fields."[6]

Adam Smith also observes the effect on rent of improved methods of transport which make land more accessible. The following passage anticipates Henry George's wider treatment of the factors that increase rent.

> "All those improvements in the productive powers of labour which tend directly to reduce the real price of manufactures tend indirectly to raise the real rent of land .... Every increase in the real wealth of society, every increase in the quality of useful labour employed within it, tends indirectly to raise the real rent of land."[7]

Smith distinguishes between ground rent and rent for buildings, noting that ground rents are "highest in the capital and in those parts of it where there happens to be the greatest demand for it." And anticipating Henry George yet again, Smith proposed that ground rents be separately taxed because, unlike taxes on buildings, this would not discourage construction activity.

Thomas Robert Malthus (1776-1834)
David Ricardo (1772-1823)

These two economists wrote about rent at about the same time and they engaged in disputatious correspondence on the subject. The theory of land rent is, perhaps erroneously, known as the Ricardian theory of rent, but there is no doubt that Ricardo dealt with it more thoroughly than had his predecessors. We need not repeat the theory, which has already been explained, except to quote Ricardo's famous

description of rent as being "that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil." This is an incomplete definition it is true, and one that is continually being contested on the grounds that the soil is not indestructible - hardly a damaging blow to the theory of rent! "Corn is not high because rent is paid", said Ricardo, "but rent is paid because corn is high". And of course, it was borne out by the corn laws that high prices increased rents, not the reverse.

Later economists found a number of points on which to challenge Ricardo but, while there were some weaknesses in his exposition of how rent arose, notably his law of diminishing returns in agriculture, much of the opposition was political. Adam Smith had already had a dig at landlords who, he said, loved to reap where they never sowed, but Ricardo spoke more plainly:

> "... the interest of the landlord is always opposed to the interest of every other class in the community. His situation is never so prosperous as when food is scarce and dear: whereas all the other persons are greatly benefited by procuring cheap food."[8]

Charles Carey (1793-1879)

Land, to Carey, was just another form of capital so that rent as a separate category was eliminated. Rent was only interest for capital invested. Like Locke, Carey argued that the value of land was due solely to the labour employed in its improvement. He attacked Ricardo's economics with vigour but his political prejudices were not concealed.

> "Mr Ricardo's system is one of discords ... its whole tends to the production of hostility among classes of nations .... His book is the true manual of the demagogue, who seeks power by means

of agrarianism, war and plunder."

Carey was also an ardent protectionist.

Frederic Bastiat (1810-1850)

Unlike Carey, Bastiat was a free-trader and this eminent French economist attacked the protectionists with wit and logic. However, like Carey, he attacked Ricardo on his theory of rent and defended the landed proprietors. He also viewed rent as a form of interest on improvements made to land.

Bastiat had nothing to offer in reasoned argument against the theory of rent, the basis of which is the differential in fertility and location. This was all ignored. Bastiat chose a poor and transparently false argument to sustain his views, based on the unreal situation of apparently abundant free land for the taking. And of course, differences in fertility and location were ignored. The following dialogue is between an American landowner and a prospective tenant farmer:

"*Proprietor:* What! You would give me no greater rent than the interest, at the current rate, on the capital that I have actually laid out?
Farmer: Not a cent more.
Proprietor: Why so, pray?
Farmer: Just for the reason that with the outlay of an equal capital I can put as much land in as good condition as yours.
Proprietor: That seems conclusive. But consider that when you become my tenant, it is not only my capital that will work for you, but also the productive and indestructive power of the soil. You will have enlisted in your service the marvellous influences of the sun and the moon, of affinity and electricity. Am I to give you these things for nothing?
Farmer: Why not, since they cost you nothing, and since you derive nothing from them any more than I

do?
Proprietor: Ricardo and Proudhon, however ....
Farmer: A fig for Ricardo. We must either treat on the basis that I have laid down, or I shall proceed to clear the land alongside yours, where the sun and the moon will work for me gratis."

John Stuart Mill (1806-1873)

Although Mill sought to modify some of the concepts of Ricardo, he agreed with the essentials of the theory of rent that Ricardo laid down. He also followed Smith and Ricardo in identifying land rent as an unearned increment.

> "The progress of a society constituted of landlords, capitalists and labourers tends to the progressive enrichment of the landlord class ... the increase of population tends to transfer all the benefits derived from agricultural improvements to the landlords alone."[9]

Mill regarded the private ownership of land as wrong.

> "The essential principle of property being to assure to all persons what they have produced by their labour and accumulated by their abstinence, this principle cannot apply to what is not the produce of labour."

Despite this, Mill proposed a tax only on increases in land value.

There are numerous other contributions to the theory of rent by many other economists. They cover the effects on rent of: improvements and population; monopoly; inventions; what affects the margin; economy in the use of land; the part played by capital in determining rent, etc. But these are not our concern for the moment. It is necessary for our purposes only to establish that the basic principle of the Ricardian law of rent has proved unassailable

to economic argument even to this day. Indeed it is accepted and taught by modern economists. As Henry George put it, the law of rent has all the characteristics of a self-evident truth.

It was because of the political inferences of the law of rent, which are impossible to avoid, that later, *political* economists, finding these unpalatable, diverted attention from them by extending the differential rent concept to factors other than land. Any "surplus" or "gains" accruing to labour and capital were thus designated "rent" and whatever was asserted of rent applied to all the factors of production. This, as was calculated, emasculated the firmly established concept of land as a unique factor in the production of wealth.

Gottlieb Hufeland (1760-1817)

The responsibility of first introducing the new concept of rent rests with Hufeland. He took what we will call for convenience the "left" view. It was derived from nature alone; its possessor could deny its advantages to others unless they paid him for them. Rent was unearned.

To these "natural resources" of wealth belong two classes:

1. Human talent, capabilities, quality of mind, heart and character.
2. The land.

Hufeland describes the rent of capital, the rent of talent and skill and the rent of land. He does this on a differential scale, regarding all these types of "rent" as "sheer gain".

Of course, taking a given starting point as representing the margin, there is almost no kind of measurement that cannot be established along these lines and there would be nothing more remarkable about it in economics than there is in physics when temperature, the tensile strength of materials, density, etc., are calculated from a given starting point, were it not for the political advantages to be

gained from confusing the factors of production and consequently the avenues of distribution.

In the same manner, and for the same reason that slaves were regarded as "property" (wealth); that land was regarded as merely another form of wealth or as capital; that value had nothing to do with labour; that improvements could not be separated from the gifts of nature; that the value of land was due to improvements made to it; that over-population was responsible for poverty, so in the same manner and for the same reason has the concept of rent of land been relegated to just another form of rent.

Thus we arrive at the conclusion implied, if not specifically stated, that the rent of land is no different from other forms of rent; therefore land is no different from the other factors of production and requires no special treatment either in economics or in morals. Thus, moral conclusions are conditioned by economic ones.

Other German economists contributed to the new rent theory, and even the entrepreneur was included as being a subject for rent calculation. At the root of these calculations of rent was the concept of scarcity or exclusively-enjoyed advantages of whatever nature.

Samuel Bailey (1791-1870) has the honour of being the first English writer to propound the new theory. Quasi-rents, scarcity rents and pseudo-rents were terms that became popular but today the simple term "economic rent" is used.

We will end with *Everyman's Dictionary of Economics*, the authoritative publications to which we have previously referred. Under "Economic Rent" we are told that rent is an economic surplus:

> "... the earnings of a factor of production in excess of the minimum sum necessary to keep it in its existing use and prevent it moving to other uses."

It is then explained that the term rent is used to

describe the earnings of any factor that is limited in supply and adaptable to only one use. On the subject of land rent, the authors have this to say:

> "... economic rent is now recognised as an element likely to enter into the incomes of all factors to some extent, rather than as a separate category of income earned only by one type of factor."

This argument has been adopted by socialists who regard Henry George's proposals to collect the rent of land for public purposes while leaving the earnings of capital in private hands, as the "capitalists' last ditch"; only by taking over the means of production *in toto* will justice be done.

On the other hand, what we will term the "right" view seeks, by adopting the corrupted theory of rent, to justify the *private* appropriation of all "rent" – and it is not difficult to defend "rent" of ability or "rent" of capital since such "gains" are not anti-social.

The pattern of *political* economics in this matter emerges without necessarily giving rise to a conspirary theory. Rather can it be described as a sectional self-interest theory.

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1. Quoted in *Theory and Measurement of Rent*, Chilton Company, Philadelphia, 1961.
2. Ibid.
3. Book I, Chapter VI, *Wealth of Nations*.
4. Ibid, Chapter XI, Part I.
5. Ibid, Chapter XI, Part II.
6. Ibid, Chapter XI "Of the Rent of Land".
7. Ibid, Chapter XI "Conclusions of the Chapter".
8. Principles of Political Economy and Taxation.
9. *Principles of Political Economy*, Book IV, Chapter III.

CHAPTER 10

The Distribution of Wealth

THE TERM "distribution" in political economy does not mean transportation and exchange. Political economy is the study of the natural laws governing the production and distribution of wealth. The term distribution means the allocation of wealth among the factors engaged in producing it. The term has suffered, since the time of John Stuart Mill, from more than one interpretion. Mill asserted that, although economic laws governed the *production* of wealth, the *distribution* of wealth was governed by man. This view has had, and still has, serious consequences in the formulation of policies for a more equitable distribution of wealth and has led to the popular idea that it is the task of government to re-distribute wealth by intervening in the economy.

Strangely enough, those who were prepared to accept that the distribution of wealth was subject to the laws of political economy also argued that man's intervention was necessary to counter the maldistribution of wealth. If natural economic forces produced poverty, then it was man's job to rectify the forces of economic laws.

How could this matter be resolved? Here was a dilemma for those who did not believe in interfering with the natural laws of political economy.

But there is yet another way in which the term distribution has caused problems. Like the term rent it

has had its meaning diluted. Take for instance this quotation from *A Dictionary of Economic Terms*[1], a book for students which has run into 15 editions.

> "*Distribution.* That section of economics which inquires into the manner in which the total income of the community is divided among the various classes of claimants for a share of it. There are, broadly, three such categories: wage-earners, salary-earners and those in receipt of rent, interest, profits and dividends. The actual division between these three categories of total 'personal income' may be studied in the national income statistics now compiled annually by the British and other governments."[1]

There has also been a shift in emphasis in defining distribution. The study of the laws that determine the rewards to the factors engaged in production has been shifted to the study of how the entrepreneur reacts to the cost of these factors when employing them in his business. Further confusion has been brought about by including the law of variable proportions (a valid concept in itself) and marginal productivity under the heading of distribution.

In the resultant muddle, the nature of the distribution of wealth and its place in political economy has been lost sight of. It is not surprising therefore that many economists argue that economics is not a science. Faced with these confusions, students can hardly be blamed for agreeing.

Let us trace the processes of thought on the subject of distribution beginning with John Stuart Mill's statement on it and Henry George's penetrating criticism of this:

Here is Mill's key statement:

> "The laws and conditions of production of wealth partake of the character of physical truths. There is nothing optional or arbitrary in them. Whatever

mankind produces must be produced in the modes, and under the conditions, imposed by the constitution of external things, and by the inherent properties of their own bodily and mental structure.... But it is not so with the Distribution of Wealth. That is a matter of human institution solely. The things once there, mankind individually or collectively can do with them as they like. They can place them at the disposal of whomsoever they please, and on whatever terms. Further, in the social state in every state except total solitude, any disposal whatever of them can only take place by the consent of society, or rather of those who dispose of its active force. Even what a person has produced by his individual toil, unaided by anyone, he cannot keep, unless by the permission of society.... The distribution of wealth, therefore, depends on the laws and customs of society. The rules by which it is determined, are what the opinions and feelings of the ruling portion of the community make them, and are very different in different ages and countries; and might be still more different, if mankind so chose."[2]

George replies:

"We are deliberately told that the laws which it is the object of political economy to discover, are, in the first part of its inquiries, natural laws, but in the later and practically more important part of those inquiries, they are human laws! Political economy of this sort is as incongruous as the image that troubled Nebuchadnezzar, with its head of fine gold and its feet part of iron and part of clay, for in the first part its subject-matter is natural law, and in the last and practically more important, it is human law....

"The plausibility of the argument comes from the leading proposition - 'The things once there, mankind individually or collectively can do with them

as they like.'

"It is evidently this that, in the mind of Mill himself and in the minds of the professors and students who have since gone over his 'Principles of Political Economy', has seemed to prove beyond peradventure that, though the laws of production may be natural laws, the laws of distribution are human laws. For in itself this proposition is a self-evident truth. Nothing, indeed, can be clearer than that 'the thing once there, mankind individually or collectively can do with them as they like' - that is to say, wealth once produced, human law may distribute it as human will may ordain.

"Yet while this proposition that things once there mankind can do with them as they like, is in itself irrefutable, the argument in which it is introduced is an egregious instance of the fallacy called by the logicians *petitio principii,* or begging the question. The question that Mill is arguing is whether what is called in political economy the distribution of wealth is a matter of natural law or a matter of human law, and what he does is to cite the fact that in what is called in *human law* the distribution of wealth, mankind can do as they like, and assume from that that the distribution of wealth in the *economic* sense of the term is a matter of human law - 'a matter of human institution solely' ....

"How then can we talk of natural laws of distribution? Laws of nature are not written or printed, or carved on pillars of stone or brass. They have no parliaments, or legislatures, or congresses to enact them, no judges to declare them, no constables to enforce them. What then can we really mean by natural laws of the distribution of wealth? What is the mode or method by which without human agency wealth may be said to be distributed by natural law, and without human agency, among individuals or classes of individuals? Here is the

difficulty that not having been cleared up in economic works has given plausibility to the assumption into which the scholastic economy has fallen in assuming that the only laws of distribution with which political economy can deal are not natural laws at all, but only human laws – an assumption that must bring any science of political economy to an end with production."

Henry George then gives a compelling example of the manifestation of the law of nature that governs the distribution of wealth – "a law preceding and superior to human will".

"A shifting of desert sands reveals to a roving tribe wealth produced in a long dead civilisation – rings, coins, bracelets, precious stones and delicately carved marbles. They have been produced. The tribesmen individually or collectively can do with them as they like – can place them at the disposal of whomsoever they please, and on whatever terms. Nature will not interfere....

"But things freshly produced this day or this minute are as truly *here* as things produced centuries ago. Why should not mankind individually or collectively do with them also as they like; place them at the disposal of whomsoever they please and on whatever terms they choose? They could do so with no more remonstrance from the things themselves or from external nature than would attend the rifling of Egyptian tombs by Bedouins. Why should not civilised men rifle the products of farm or mine or mill as soon as they appear?

"Yet it needs no economist to tell us that if in any country the products of a living civilisation were treated as the Bedouins treat the products of a dead civilisation, the swift result would be fatal to that civilisation – would be poverty, famine and death to the people individually and

collectively. This result would come utterly irrespective of human law. It would make no difference whether the appropriation of 'things once there' without regard to the will of the producer were in defiance of human law or under the sanctions of human law; the result would be the same. The moment producers saw that what they produced might be taken from them without their consent, production would cease and starvation begin. Clearly then, this inevitable result is not a consequence of human law but a consequence of natural law."

Production, continues George, is not to be conceived of as something that goes on for a while and then stops, or as something that, once wealth has been brought into being, is finished and done with.

"Both production and distribution are properly conceived of as continuous, resembling not the drawing of water in a bucket but the drawing of water through a pipe - or better still, in the conveyance of water over an elevation by means of a bent pipe or siphon, of which the short arm may stand for production and the longer for distribution. It is in our power to tap this longer arm of pipe at any point below the highest, and take what water is *already there*. But the moment we do so, the continuity of the stream is at an end, and the water will cease to flow.

"Production and distribution are in fact not separate things, but two mentally distinguishable parts of one thing - the exertion of human labour in the satisfaction of human desire. Though materially distinguishable, they are as closely related as the two arms of the siphon. And as it is the outflow of water at the longer end of the siphon that is the cause of the inflow of water at the shorter end, so it is that distribution is really the cause of production, not production the

cause of distribution. In the ordinary course things are not distributed because they have been produced, but are produced in order that they may be distributed. Thus interference with the distribution of wealth is interference with the production of wealth and shows its effect in lessened production."

Attempts to regulate wages, to regulate prices and to regulate rent, have all failed because they have come up against the natural laws of distribution which continue to assert themselves in the form of strikes, tax evasion, black-marketeering, etc. The laws of distribution being the laws which determine ownership of the things produced, the law of property and the law of distribution are in reality different expressions of the same fundamental law.

The importance of the foregoing is paramount, for as Ricardo says in the preface to his *Principles of Political Economy*, "To determine the laws which regulate the distribution of wealth is the principal problem in Political Economy."

What are the views of present day economists? What is now taught as to the nature of distribution? If the definition quoted at the beginning of this chapter, putting wage-earners into one category, salary-earners in the second and all the rest including rent and interest into the third, is anything to go by, then one can only feel sympathy for the students who have read the fifteen editions of this dictionary. The National Income statistics referred to have no relation whatsoever to the strictly economic definitions in political economy... Hanson's dictionary[3] does a little better for we are given a choice - and the opening definition of distribution is reasonable.

"One of the main divisions of economics, distribution, is concerned with the principles underlying the sharing out of the national income among the

owners of the factors of production."

But then we are distracted by references to the "marginal productivity theory of distribution" – which asserts that it is the marginal productivity of a factor that determines its share of the total. Shades of the marginal utility theory of value! For, in the same way that marginal utility is supposed to determine exchange value, so marginal utility (or marginal productivity) determines distribution. Whatever relevance or use this may have in business economics, it certainly has none in the study of economic science.

The alternative "approach" offered by Hanson applies the principles of the market to the determination of the rewards of the factors so that we get, through the interaction of supply and demand, "the pricing of the factors of production". Not perhaps entirely satisfactory, but certainly more relevant than the "marginal productivity of the factors of production."

Everyman's Dictionary of Economics[4], already referred to in this booklet as an authoritative source of economic wisdom, gives under the heading of distribution the same but more detailed explanation as that given by Hanson. But the authors, after saying that modern economic theory has never been able satisfactorily to solve this problem of the determination of relative shares, goes on to talk of the law of variable proportions (an economic concept often referred to as the law of diminishing returns) in relation to the marginal productivity of factors of production and of marginal utility.

Thus the original concept of distribution as laid down by the classical economists is overlaid with ideas which have nothing to do with it and attention is diverted from the most important considerations emphasised by Henry George. Alexander Gray, in his previously mentioned book *The Development of Economic Doctrine*, refers to John Stuart Mill's exposition of

the nature of distribution. He comes down emphatically on the side of Henry George although his name is not mentioned. After outlining Mill's statement that the laws of production are natural ones and the laws of distribution man-made ones (things once there, man can do what he wills with them), Gray says:

> "Such is Mill's rigid distinction between the field of production where inexorable law, uncontrolled by man, prevails, and the other field of distribution, which is also doubtless subject to a law, but to a law of man's making and revising. It is almost unnecessary to observe that Mill's strict line of differentiation is indefensible. Doubtless 'the things once there', an omniscient, omnipotent, omnicompetent parliament may decree any distribution which, in its lack of wisdom, may seem good to it; but if in these matters it errs against popular sentiment, it will not be long until the things are not there. An unquestioned power to control distribution brings little comfort, if the exercise of that power dries up the stream of production, and so leaves nothing to distribute. The difference here from the older classical economists is obvious. For them the laws of distribution were as inexorable as any other. Mill, in sweeping all this into a sphere controlled by human volition, made it possible for him to be the speculative reformer, calmly contemplating the coming of the communistic state."

Well, the coming of the welfare state at least, for this is the consequence of Mill's approach to distribution and that of any others who have followed down the path he trod.

State economic planning (which frequently attempts to legislate against economic laws), state medicine, state schools, state housing, state subsidies, protection and controls, nationalisation, taxation, etc., all have their roots in Mill's philosophy,

humane as it is in its origin.

But what of the contrary view to that of Mill? Alas, it has led to precisely the same things and it could hardly do otherwise. If the natural laws of distribution are responsible for the chronic poverty and destitution everywhere observable, then man (in the shape of the state) must in the name of charity intervene.

The missing piece to this jigsaw was provided by Henry George and others who thought like him. The distribution of wealth was to the factors responsible for production. But though the worker contributed *his* labour and the capitalist *his* capital, the landowner did not contribute *his* land. This was the fundamental flaw - *not an economic one but a moral one*. The distribution of rent is to the factor land, or more accurately to whoever holds possession. The laws of distribution are amoral but human institutions which permit the private appropriation of the rent are not. There is nothing in the laws of distribution that causes poverty, but everything in human institutions that does.

There has been a tendency throughout the history of economics, right up to the present time, to dismiss, cover-up, corrupt, ignore or misrepresent those economic ideas which have unacceptable political implications. Such economic ideas include: the labour theory of value; the theory of rent as it applies to land; the logical definition of wealth which excludes those things that do not result from the work of man's hands; the distinction between land and capital; the distinction between values that arise from production and those that arise from obligation; and the true laws of distribution.

It is no doubt true that because of Henry George's advocacy of the single tax, his contribution to the study of the science has been dismissed as being not worth consideration.

But theories and logical thinking are neutral and independent of the interest of the presenter. Pro-

positions in political economy as in all the sciences should be judged by the truth of their premises and by the logic of their conclusions.

In Alexander Gray's account of the economic theories of Sismondi, a Luddite in thought, a welfare statist in aims and an opponent of laissez-faire amongst other things, there appears this passage:

> "Sismondi's theory of distribution on which his doctrine of over-production rests, is one of those things which are better left to their natural obscurity. His view that the annual production of any year is bought by the revenue of the preceding year reveals a mind which was a stranger to strict reasoning. On this side Sismondi's doctrines merely possess the value of antiquarian curiosities, and as such should not be withdrawn from the museum even for purposes of examination."

Perhaps future writers on the development of economic thought will pass similar judgment on many of our modern writers of economic textbooks who regard themselves as superior not only to Sismondi, but to Adam Smith, David Ricardo and Henry George.

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1. J.R. Winton, Routledge & Kegan Paul.
2. *Principles of Political Economy*, Book II, Chapter I.
3. A Dictionary of Economics and Commerce, J.L. Hanson, 1965.
4. Arthur Selden & F.G. Pennance, J.M. Dent & Sons Ltd.