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Why You Don't Get it in College

by Harry G. and Elizabeth R. Brown

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CONTEMPORARY INTEREST THEORY

with relevant comments on

Keynesism, Communism and Property Rights

by

Harry Gunnison Brown

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Does Keynesism Offer Aid and Comfort to the Communists?

How many years must elapse and how *overwhelming* must the *evidence* become in favor of a policy they have long ignored—or dismissed with a paragraph or two of superficial criticism—before teachers and textbook writers in college economics will reveal to their students and readers the dark secret that there is, or has ever been, *any evidence at all?*

Is Your School or College an Exception?

When economics teachers leave out and their textbooks leave out—as having any significant *contemporary* interest—all consideration of what may well be the most fundamental, exciting and vital question on which economics can shed light, can their teaching possibly have its greatest and most dramatic appeal to their students?

Is an Unpublicized Professorial Fear the Achilles Heel of Capitalism's Answer to Communism?

An Oversight in the Dominant Theory of Interest

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The AMERICAN JOURNAL of ECONOMICS and SOCIOLOGY

IN A RECENTLY PUBLISHED ARTICLE,[1] Professor Paul A. Samuelson expressed the belief that "Böhm and Fisher have given us the essential insights into the pure theory of interest."

Writing in *Econometrica* in 1948, the late Professor Joseph Schumpeter of Harvard University characterized Fisher's book on *The Theory of Interest* as "a wonderful performance, the peak of achievement, so far as perfection within its own frame is concerned, of the literature of interest." And Schumpeter went on to say of Fisher's study that it is "an almost complete theory of the capitalist process as a whole, with all the interdependences displayed that exist between the rate of interest and all the other elements of the economic system. And yet this interplay of innumerable factors is powerfully marshalled around two pillars of explanation: Impatience (time discount) and Investment Opportunity (marginal return over cost)."[2] Schumpeter adds, in a footnote, that "Keynes *himself* also accepted the time-discount factor, *i.e.*, the whole of Fisher's theory."

On the basis of such comments as these, it is perhaps not unreasonable to conclude that Fisher's theory of interest is presently the dominant one.

Certainly Irving Fisher must be ranked among those who have contributed greatly to the theory of interest. And certainly he worked out more fully than Böhm-Bawerk had done, the explanation of how the preference for present income over future income affects the net (*i.e.*, in excess of allowance for depreciation) marginal productivity of capital, and how the productivity of capital affects individual rates of preference for present income over future income.

Nevertheless, there is an aspect of Fisher's analysis which seems to me and has long seemed to me to be incorrect.

I

FISHER CORRECTLY CONCLUDES that a high per cent net productivity of capital—in his phraseology, a high "rate of return over cost"—will operate to produce a high rate of interest. He correctly concludes that this high productivity will tend to bring about a high rate of preference for present income over future, *i.e.*, a high rate of "impatience." He insists, however,

[1] "An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money," *Journal of Political Economy,* 66 (December, 1958), p. 467.
[2] "Irving Fisher's Econometrics," *Econometrica,* 16 (July, 1948), pp. 225–6.

that the high net productivity of capital does not have a *direct* effect in raising the interest rate, but *only* an *indirect* effect. It raises the rate of interest *only by* or *through* raising men's rates of "impatience,"—of preference for present income over future income.

In order that the reader may form his own judgment regarding the Fisher viewpoint, I shall quote several passages. In the first of these, discussing critically a passage in Böhm-Bawerk's *Positive Theory of Capital,* Fisher says[3] that "the *only*[4] way in which the existence of long processes of production acts on interest is by overendowing the future and underendowing the present, thus creating a 'scarcity value' of present goods."

In a second passage,[5] commenting on the gains that may be secured from "a newly discovered method of exploiting capital," he says: "The effect in raising interest comes *merely*[6] from the shifting forward of the income stream, which leaves the immediate income smaller than before, but compensates for this by a still greater increase afterwards."

In a third passage, replying to a reference by H. J. Davenport to equipment loans (loans to persons or corporations that are borrowing for the purpose of securing equipment—capital instruments—to aid in production), Fisher contends that[7] such loans "are made for the purpose of securing large incomes in the future, and larger incomes mean larger consumption. Production loans then are made only in contemplation of future consumption. Hence, though loans for the acquisition of intermediate goods do greatly preponderate in the loan market, these loans have power to affect the interest rate *only by*[8] changing the relative amount of future incomes compared to present incomes."

If I have correctly interpreted these passages in Fisher, the views expressed can be stated in five propositions, as follows:

1. A high net marginal productivity of capital—"marginal rate of return over cost"—encourages investment in capital in order to realize this gain.
2. Such investment in capital for the sake of larger future income, involves sacrifice of present income.
3. This sacrifice of present income strengthens the desire for present income which has thus become scarce and weakens, relatively, the desire for future income which now promises to be larger,—thereby raising the rate of preference for present income over future, the "rate of impatience."
4. Because of this higher "rate of impatience," the rate of interest rises.
5. The effect of the productivity of capital on interest is brought about *only* via these successive steps.

[3] *The Rate of Interest,* New York, Macmillan, 1907, p. 72.
[4] Italics are mine.
[5] *Ibid,* p. 199.
[6] Italics are mine.
[7] *The Theory of Interest,* New York, Macmillan, 1930, pp. 433–54.
[8] Italics are mine.

However much of truth there is in the passages I have quoted, they do not contain the *whole* truth. They leave out, in fact, an *important part* of the truth. A high marginal productivity of capital—a high "rate of return over cost"—has a *direct* effect on the interest rate, *apart from* any indirect effect it produces on interest by first changing the rate of preference for present income over future.

II

Let us suppose the net marginal productivity of capital (the yield above depreciation) to be or to become 8 per cent a year. And let us use the simplest, the least complicated, illustration we can. John Deckleburg, a fisherman, is able to catch 1,000 fish a year, with which, as best he can, he provides for himself and his family. If he should be able to build a boat, he could thereafter catch enough *more* fish per year to cover depreciation of the boat (*i.e.,* repay the cost of the boat during its life) and, in addition, get 80 more fish—8 per cent return *above* cost—per year. He can build such a boat during a year—thus its cost of production is the 1,000 fish he could otherwise catch during the year—*if* he can borrow 1,000 fish during the year to live on. For then he will *not* have to spend the year catching fish and *can* devote the year to building the boat. And *because* the boat will yield—or earn—8 per cent on its cost of production, it will *pay* him to borrow at any interest rate below 8 per cent. It will pay him to borrow at 3 per cent, 5 per cent, 7 per cent or 7.9 per cent. The fact that there is an 8 per cent *gain* from using capital, *i.e.,* from roundabout production, makes him willing to offer interest to a lender. It gives him a *motive* to bid against other potential borrowers.

Does not this 8 per cent net marginal productivity—an 8 per cent "rate of return over cost"—motivate him *directly?* Surely we have here a preference for *more* against *less.* And surely this preference for *more* rather than *less* does *not* arise *because* preference for present income over future has risen. The preference for *more* rather than *less* is an influence in its own right and can act directly. It is *not* an influence which can make itself felt *only via* first setting into motion the other influence of "impatience."

It is, in my opinion, correct and more realistic to recognize that our fisherman, John Deckleburg, *could have his living from day to day without borrowing;* that he does *not* borrow *in order to* be able to enjoy appreciably more fish—or other present income—this week or this year; that, on the contrary, he borrows in order to be able to *build the boat instead* of having to *spend* his time *catching present fish* for present needs; that he borrows in order to be able to carry on roundabout production; that, in short, he borrows chiefly, if not solely, because he *prefers more to less* and *not* because he prefers present income to future income or earlier income to later income. This is the emphasis that the Fisher analysis—like the analysis of Böhm-Bawerk earlier[9]—seems to lack.

It is the same if we consider the case of a potential lender. He also can be motivated directly by a preference for more as against less, just as certainly or as much as by a preference for present income over future income. Suppose that he is able to produce more than he and his family need to consume, and thus is able to save. Then this excess producing, and saving, can take the form of productive capital from which he can hope to enjoy a return. If he is unwilling to lend to another for 5 per cent or 7 per cent, this may be because, by using his savings himself in the form of productive capital, he believes he will be able to gain 8 per cent. In that case, the *reason* he does not appear on the supply side of the borrowing and lending market is *clearly* that he *prefers more to less.* His reason for not lending *does not have to be* that he prefers present income to future income by 8 per cent. It can well be that he is influenced far more by his opportunity to *use* his savings profitably *himself* than by any desire to enjoy more present income at the expense of having less future income.

Then how can it be said that the productivity—or the anticipated productivity—of capital, affects his interest offer *only by* and *through* first making his present income comparatively small and thus increasing his preference for present income over future income?

A potential lender may be influenced by a preference for more as against less, or by a preference for present income as against future income, or by both. Preference for present income as against future may affect the amount of saving, thus the amount of capital and thereby the

[9] See my paper, "An Off-Line Switch in the Theory of Value and Distribution," *Am. J. Econ. Sociol.*, Vol. 3, No. 4; also reprinted in *Some Disturbing Inhibitions and Fallacies in Current Academic Economics*, New York, Robert Schalkenbach Foundation, 1950, Chapter 4. See also my *Basic Principles of Economics*, 3rd ed., Columbia, Mo., Lucas Brothers, 1955, Chapter XIII, especially pp. 326–55. This chapter grew out of an article published in the *Quarterly Journal of Economics*, August, 1913, entitled "The Marginal Productivity versus the Impatience Theory of Interest."

marginal productivity of capital. The productivity of capital may affect the amount of saving and may thereby affect the distribution of the saver's income between present and future and, hence, the degree of his preference for present goods. But that preference for more as against less can have no effect on the loan market and the interest rate *except through* its effect on preference for present income over future income, is simply *not true.*

Yet Fisher's study presents so carefully and thoroughly the various interrelations involved in the matter of the interest rate, the "impatience" rate and the net marginal productivity of capital, that one is tempted to assume he realized clearly the direct effect of capital productivity on the interest rate. It is his insistence, in the passages quoted, that the net productivity of capital has *only* an *indirect* effect, and the thought that students of Fisher's analysis will—and presumably do—so interpret him and themselves accept this view, that are the justification for these comments.

Chapters 2, 3, 4 and 5 consist of excerpts offset printed from chapters 11, 13, 14 and 9 respectively of

THE EFFECTIVE ANSWER TO COMMUNISM
and
Why You Don't Get it in College

by HARRY G. AND ELIZABETH R. BROWN

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2. The Vacant Lot Problem in American Cities
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4. Tax Policy and Commercial Site Development
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9. Land Value Taxation and the Rights of Property
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Foundations, Professors and "Economic Education"

I

RECENTLY I RECEIVED from the American Economic Foundation, 295 Madison Avenue, New York 17, an illustrated folder by Fred G. Clark and Richard Stanton Rimanoczy entitled "What Are Tools?" The authors state that "any piece of mechanical equipment is a tool of production." Then they go on to include among such tools not only the roof over the equipment, the walls around it and the floor under it, but also "the land under the floor." And then they add: "A coal mine, an oil well, a forest, an ore deposit, or any other natural resource becomes a tool of production to the men who extract from nature the raw materials which go into manufacturing."

By thus putting all land and, in general, all natural resources into the category of "tools," the authors turn the reader away from considering a very fundamental question. This fundamental question is whether an income derived from man-made equipment that *cannot come into existence at all* unless there is *both labor and saving,* is on no stronger an ethical and social utility basis than is an income one can receive just because others must pay him for his *permission* to work on and to live on the earth, in those locations made productive and desirable because of geological forces and community development, and for his *permission* to withdraw fuels and minerals from the earth's subsoil deposits.

Lest this statement seem to some readers not entirely clear, we may illustrate by reference to the case of New York City.[1]

New York is situated on a great natural harbor. If there were none to use the harbor except a few pioneer farmers on Manhattan Island trading their surplus produce for the textiles and other goods of Europe, landing space for a very few boats or perhaps for a single one would be all that would be needed. But as the rich interior of the North American continent was settled, with its mines of iron ore, copper and coal, its prairie and river-bottom wheat and corn land, and its other resources, more and more goods were produced to be poured through the port of New York into foreign countries. And, of course, more and more foreign goods were wanted in exchange, which could most advantageously pass through

[1] The following five paragraphs are taken, with only slight changes, from my *Basic Principles of Economics,* 3rd edition, Columbia, Mo. (Lucas Brothers), 1955, vol. I, pp. 490–1.

the same port. Today there is needed in New York City a large population to meet the requirements of this great tributary country.

If all the present population of New York were whisked away overnight, the land of New York would still have great value because of the need for millions of men and women on it to serve the commerce of the back country. A new population would move in and take up the important work for the rest of us which can be done nowhere else so well. Those who own that part of the earth's surface would be in a position to make this new population pay handsomely for the privilege of working for us there and of living where we need to have them live in order that this work may be effectively done. In short, the newcomers would have to pay for *permission* to work and to live on that part of the earth.

The demand of the tributary country for this service makes a demand for the use of the land by the people who must live and work there in order to render the service. Incidentally, too, it makes necessary a tremendous demand—and correspondingly high rents and values—for the use of especially well-situated lots for the location of department stores, lunch rooms, banks, lawyers' offices, etc. Such sites and buildings are needed to shelter those who supply near at hand the requirements of those who must live there to serve the non-sea-coast sections.

Surely, the rent of land is in a very peculiar sense socially produced rather than individually earned, and ought to be sharply distinguished in thought from interest on capital produced by men's labor and saving. And if there is any kind of return which is peculiarly fitted to be a source of public revenue, it is the rent of land.

In this connection we must remember that fertility elements put into the soil—including fertility elements maintained through constant renewal —by a farmer, are, in the economic sense, capital rather than land. In the city we construct capital mostly *on* the land. In the country we often put it, largely, *into* the land. The investment in such fertilizing of the land is capital as truly as the buildings, drainage systems, terracing, planted fruit trees, machinery and livestock.

No one can deny, of course, that the building of roads and railroads and the way in which population is distributed near or about a given piece of land affect the usefulness of that land for production and so affect its value. *Such* value is *community*-produced and is *not* produced by the owner of the land. An individual or a comparatively small group of individuals may produce or reproduce a house, a machine, a factory or a locomotive. But no group that does not approximate a hundred million or more in numbers can produce, or reproduce, the situation advantages of

Manhattan Island. Such situation advantages are, in the main, by-products of activities not directed to the end of producing these advantages. When all superficial resemblances are allowed for and all qualifications made, it remains true that there is, in general, a most significant distinction between land and capital, a distinction of the greatest importance for public policy.

If facts like these were noted in the Clark-Rimanoczy pamphlet or folder, there might be readers who would wonder whether an income received from being able thus to charge others for *permission* to work on and live on the earth, should not be taxed more heavily than income derived from capital *brought into existence by work and saving*. Instead the authors hurry their readers on to the statement that "profit" is collected from customers "on behalf of the people who supply the tools of the business," that "profit is the key to tools and tools are the key to prosperity." Without a hint that the *earth* with its subsoil deposits and other resources was not made by men and that its *existence* is *not* the result of "profit," they hurry along to the statement: "No profits, no tools—no tools, no prosperity."

Then, finally, comes the authors' peroration:

> When and if the American people ever become convinced that profit is evil and that suppliers of the tools do not deserve a reward, America will have reached the beginning of the end.

Thus is the incautious and gullible reader tricked into applying a perfectly logical defense of income from the tools one's work and saving have brought into existence, to the utterly *different* case of income derived from giving others *permission* to *work* on and to *live* on the *earth*, in those locations made productive and reasonably livable by geological forces and community development.

III

BUT PERHAPS one's criticism of writers on economics outside of strictly academic circles should be tempered by consideration of the extent to which academic economists have blurred the distinction or, even, ignored or denied the distinction between capital and land and the distinction between income from the one and the other. Some textbooks do not even have the word "land" or the word "rent" in the index, and *not a few* omit *all* reference to land-value taxation.

Among the economists of the latter part of the nineteenth century and the earlier part of the twentieth, whose influence was the greatest in leading other economists to blur the distinction between capital and land, we ought certainly to include John Bates Clark. In his book on *The Distribution of Wealth*,"[7] "land" is included in "capital" and the income from either or from both together is "interest." The *only* other income is, in Clark's analysis, "wages," except that, in a "dynamic" state there may be "profits." The following passage from this book, in which Professor Clark discussed the contention that capital differs from land because the former can be increased by men, is especially relevant.

> Let us, then, compare *all* land with *all* other capital goods; let us take all society into the field of view. In every group and sub-group there is land, and in every one there is capital in the form of artificial instruments. Neither the one agent nor the other can be increased in the aggregate at will. At any one time the amount of artificial capital in existence is as fixed as is the amount of land. Within any short time it is impossible to increase the general fund of artificial capital enough to make a perceptible difference in the conditions of social industry. At any one time we have to deal with a definite quantity of land, in combination with a definite amount of capital in artificial forms. Moreover, the distinction between land and other capital-goods, based on the notion that land cannot be increased and that other things can be, has obviously no validity in a static study; for the static assumption itself precludes all increase of capital.[8]

Here Clark is saying that one reason for classing capital and land together is that, even though we regard land as fixed in amount, yet "artificial capital," too, is "fixed" in amount at "any one time" and *cannot be increased enough* "to make a perceptible difference," etc., within "any short time" and that, anyway, if we *assume* a "static state," then artificial capital, like land, *cannot be increased at all!*

Here is the essence, in Clark's own words, of his viewpoint on the distinction between interest and rent:

> What, then, is interest? Is it not a fraction of itself that a permanent fund of wealth annually earns? . . . Does a building, or an engine, or a ship literally earn in a year a fraction of itself? . . . The *capital* that is embodied in the buildings, the engines and the ships of the world does enlarge itself in this way. *It earns interest; but what the concrete instruments earn is not interest, but rent.*
>
> A popular and accurate use of the term rent makes it describe the amount that any concrete instrument earns. . . . In a use of terms which harmonizes with practical thought and which, as we undertake to prove, is entirely scientific, rent and interest describe the same income in two different ways. *Rent is the aggregate of the lump sums earned by capital goods; while interest is the fraction of itself that is earned by the permanent fund of capital. . . .*
>
> Science has proposed a different distinction between rent and interest. It has tried to confine the former to the product of land—and that, too, without taking account of changes in the value of land—defining it as

[7] New York, Macmillan, 1899.
[8] *Ibid.*, pp. 339–40.

what a tenant pays to his landlord for the use of the "original and indestructible" properties of the soil. This usage probably would never have grown up if the science of political economy had originated in America, where land has always been a commercial article, and where the man who buys a piece of it reckons whether he can get as good interest on his investment in that form as he can in any other.[9]

It is true that the return on land and the return from capital can be stated, either of them, as a percentage or as a lump sum.[10] *Superficially*, then, the return from land and that from capital may seem much alike. But this is *only superficially*. For the return from capital is naturally reckoned as a percentage and ought to be so reckoned—a per cent on the *cost* of the capital. What we are interested in knowing in the case of the return from capital, is how much more we gain by following a roundabout process than a direct process of production, and how much the extra product amounts to *in comparison with* what the product would be had immediately consumable goods (present goods) been produced instead. In other words, we are concerned with knowing the per cent of the excess gain from roundabout production to what would be or would have been secured by direct production. In short, we are concerned with the fact that capital normally yields, during its lifetime, *more* than its cost of production (measured in the present—or consumable—goods and services that might be or might have been produced instead); and we are naturally and properly interested in knowing how large this gain is *in relation to* the *cost* of producing the capital which makes it possible.

But the value of land is *not* measured by any "cost" of "producing" the land. Hence it is essentially meaningless to inquire as to the per cent yield on *cost*.

It may be said, however, that Clark and the other economists who follow him do not refer to a per cent of cost of production but to a per cent of *value*. And, it may be asked, why is not the per cent of the value of land a matter of significance just as is the per cent gain on the value—and so the cost—of capital.

The answer is that the value of land depends on the expected future yield *and* on the *per cent* at which this expected yield is capitalized into a present value. The market rate of interest used in such a process of capitalizing, itself depends largely on and tends to be equal to the rate

[9] *Ibid.*, pp. 123–4 and 137.

[10] See, for further analysis here, my article, "An Off-Line Switch in the Theory of Value and Distribution," *Am. J. Econ. Sociol.* (July, 1944). This article was reprinted in 1950 as Chapter 4 of *Some Disturbing Inhibitions and Fallacies in Current Academic Economics*, New York, Schalkenbach. See, also, my *Basic Principles of Economics*, *op. cit.*, vol. I, chaps. XII and XIII.

of net marginal yield of capital on the cost of production of capital. Knowing the *cost* of capital in terms of present consumable goods and services, and knowing the rate of *net marginal yield* on this cost, we know the per cent interest rate which should be used in capitalizing the anticipated future rent of land into a present sale value. Thus, the sale value of land *has no independent significance* but is merely a derivation from the anticipated rent of land and from an interest rate which is *a function of the productivity of capital.* To talk about the rent of land as a per cent on its value is, therefore, to emphasize as if it were important, a per cent of a value which itself can be arrived at *only by knowing that per cent in advance.*

The rent of land, then, is logically and properly expressed as a lump sum—in dollars; while the interest on capital is logically and properly expressed as a per cent on cost.

One wonders how many of the numerous neo-classical and other contemporary economists who have followed Clark in his analysis have plumed themselves, like Clark, on having seen more deeply into the problem of land rent than did Ricardo and other economists of the earlier (*i.e.*, not "neo") classical school; whereas actually they have seen less deeply into it.

One wonders, too, whether there have not been a number of neo-classicals of conservative bent who, confronted with the contention of Henry George that the rent of land is the most ideal source of public revenue, and reacting antagonistically to this contention but in doubt as to just how to meet it, have been relieved at the thought that land rent is really a *per cent* just like *interest on capital;* and have felt that now, indeed, they could confound the land-value-taxers and discredit their philosophy!

But possibly the day has finally passed of easy victories over the land-value-tax philosophy, for conservative economists who have too easily accepted, and used in their propaganda, various superficialities and half truths and outright fallacies.

Depression, Keynes' Analysis and the Tax Burden

How Keynesism Gives Aid and Comfort to the Communists

IV

If NEVERTHELESS some readers are *shocked* at the idea of taking care of any liquidity preference that might conceivably tend toward depression, by increasing the money supply, they may be comforted by two considerations. The first is that returns from capital do not now seem to be so low as to indicate any probable threat from liquidity preference, as such, in the immediate future. And the second is that there is available a very simple policy *completely ignored by Keynes,* by which, even if otherwise the "marginal efficiency of capital" to the owners of it could drop to near zero in (say) a generation or so, we might enjoy at least a *reprieve* for several years beyond that, maybe for a second or third generation or longer!

Before identifying this policy, it will be advantageous for us to note that "the marginal efficiency of capital" for the entire community or for the nation as a whole, is, under existing conditions, decidedly greater than for an individual owner or all private owners. A capital instrument may yield—its productivity may be—8 per cent a year over the amount necessary to cover depreciation. But the owner—or the lender—cannot keep this for himself. The community, state and/or nation will require a large proportion of it in taxation.

If taxation takes 3 per cent of the 8 per cent, the owner can have but 5 per cent. Let us suppose that investment in capital were actually so much increased in two or three decades as to bring the average yield of capital to its individual owners down to only 1 per cent. This would mean that the capital was still really yielding 4 per cent but that taxation was taking three fourths of that. On the supposition that investment would go on only to the point of a 1 per cent return for the investor, we would say that at that point the influence of "liquidity preference" was sufficient to prevent any further investment. The total yield may be high enough to encourage investment, perhaps for many more years or even generations, but the yield after taxes is not. Or if investment would go on only to the 2½ per cent point for the investor,[11] the existence of the 3 per cent tax would make it stop at a total per cent yield of 5½ per cent.

If, however, the tax—or taxes—were repealed and the revenue lost were made up by a much higher tax on the annual rental value of land, the entire per cent yield from capital—whether 4 per cent or 5½ per cent or whatever—would thereafter go to the individual investor in capital.

[11] Keynes, *op. cit.*, pp. 218–9.

This decidedly larger per cent yield might well be a sufficient inducement to him to forget his desire for liquidity and continue to invest. And if so, it might still be a considerable time—whether a decade or two, or an entire generation, or far longer—before the per cent yield got to the point where increase of circulating medium was needed for the purpose of offsetting the tendency to prefer "liquidity" to investment. Maybe that point would never be reached at all!

So far as I am aware, however, *no* Keynesian has ever shown, in his writing, the *slightest* favorable interest in taking taxes off man-made capital instruments and levying, instead, heavier taxes on the value of land.

Even if, in the end, it were to turn out that we must still reckon with the threat of depression from liquidity preference, it would nevertheless be an advantage to have the large amount of capital that this tax reform would bring to the communities adopting it. As long, indeed, as the total "marginal efficiency of capital" (including the part now going to government at various levels) is above *zero, i.e.,* as long as an additional increment of capital will produce an excess over its cost of production, it is certainly an advantage to have it. Labor is better equipped with buildings, machinery, etc., and output per worker is larger. If, too, because of a higher land value tax, less land is held speculatively out of use, so that, labor is *also* better supplied with good land, output per worker will be further increased. If, as Keynes seems to have believed,[12] at 2 or 2½ per cent above zero return additional investment is likely to be brought to a halt by liquidity preference, then it *has* to be true that tax relief for capital at that point or sooner, would be favorable to prosperity. And cogent theory as well as significant statistical data[13] indicate that to make up the revenue lost, largely or entirely by a heavier land value tax would give a further fillip to prosperity.

V

THOUGH KEYNES BETRAYS no interest in increased taxation of community-produced land values, he does contemplate with equanimity and seeming approval[14] "the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital." This would come about, he suggests, via a State policy aimed at increasing the volume of capital "until it ceases to be scarce, so that the functional investor will no longer receive a bonus."

At least Keynes does not assert that, if no return at all from capital is

[12] *Ibid.*
[13] *Basic Principles of Economics, op. cit.,* Vol. II, 129–36 (Ch. XI).
[14] Keynes, *op. cit.* p. 376.

allowed to the individual saver and investor, the community or nation will get, through private saving and investment, anything like as much new capital as in the past. He does not assert, even, that capital which is depreciated or obsolescent will be or would be replaced through such individual saving and investment. It would seem, then, that there could be appropriately applied to the Keynesian philosophy, the following criticism which, for years, I have been applying to Marxism.[15]

Isn't it fairly probable that a social philosophy which repudiates private enjoyment of any income from capital, *must* envisage having the State take over the function of constructing capital? And that it must envisage having the State determine how much is to be saved and compel the saving? At any rate, socialists certainly do not put their trust in any individual saving and capital construction but always contemplate control of saving and of capital construction, by the State.

This means, practically, that the State must own all capital and see that it is kept in repair. It means, also, obviously, that the State must direct the use of capital. As a result, the nation which accepts socialistic ideals inevitably accepts State control of industry. Even if such control were not inevitable in theory, all of us know that it would certainly be insisted on. The State becomes the universal employer outside of the control of which no economic life is possible.

It is well for us to understand why a government based on a socialistic ideology must be dictatorial in its relations with its citizens. Surely, in regard to saving and the construction of capital, there can be no alternative; and socialists do not contemplate any alternative. Since individuals cannot be—and certainly are not—counted on to save adequately when they are not permitted to enjoy individually the fruits of saving, they must be compelled to save.

Such compulsory saving does not necessarily mean that citizens will be consciously aware of the compulsion. The government does not say to the individual: "You must save (say) twenty-five per cent of what you receive as wages." It merely sees to it that the citizen receives less money to spend. It publicizes a "five year plan," devoting, perhaps, a fifth or a third of the nation's annually available labor to the construction of capital.

Obviously, the labor that is devoted to the construction of capital for the use of future years cannot possibly be devoted to making shoes and

[15] The next six paragraphs are taken from my book, *Basic Principles of Economics*, *op. cit.*, Vol. I, pp. 317–318. The first edition, containing these paragraphs, was published in 1942. They are reprinted in the 2nd edition (1947) and the 3rd edition (1955).

shirts, to raising potatoes, cabbages and wheat, to picking apples and cherries and to baking bread. The more the labor of the people is devoted to constructing capital for the service of the future, the less labor can be devoted to the service of the present and the less the people can have to enjoy this year and next.

But in a socialistic State, the individual has no choice in the matter. Government decides for him and allows him, as wages, only what its central planning committee sees fit to allow. If this is not compulsion, what does the word mean? And are we perfectly certain that a nation can be organized for compulsion in this respect, with the government owning, operating, and increasing or decreasing at its pleasure, all productive capital, yet maintain in its individuals spontaneity, initiative, and a spirit of free inquiry and uninhibited criticism?

The clear logic of the matter, therefore, indicates not only that to relieve capital from taxation, so far as we can, by drawing heavily on the annual rental value of land, tends definitely to the strengthening of the free private enterprise system. The same logic indicates that to follow the opposite policy, *i.e.*, to abolish the tax on land and take by taxation practically all the yield of capital, must lead to the management of all or practically all industry by the State, with saving thereafter compulsory.[16]

The community or State which follows the first of these two divergent tax systems will have, because of it, less good land held out of use and more productive capital. Thereby its workers will be able to produce more and to earn more. Thus, although few of them, if any, are aware of the fact, a land value tax, *within the limits of what it can yield,* is more advantageous to workers than the most sharply graduated income tax. And *this is true even for those workers* whose exemptions are sufficient so that they *pay no income tax at all.*

Keynesism is, obviously, closely related to—though not absolutely identical with—the economic philosophy of the Communist-dominated States, in its explanation of business depression and, to a degree, in other ways. The view of Rodbertus, Mummery and Hobson, accepted by Lenin and his followers,[17] that business depression results from inequality—that the workers, exploited by their capitalist employers, do not receive enough to buy what they have produced[18]—appears in Keynes with liquidity

[16] "Academic Freedom and the Defense of Capitalism," *Am. J. Econ. Sociol.*, 15 (January, 1956), p. 179.

[17] Robert L. Heilbroner says the view was "embroidered into the royal cloak of Marxist doctrine" by Lenin. See *The Worldly Philosophers*, New York, Simon and Schuster, 1953, pp. 186–91.

[18] See, for an analysis and criticism of this theory, my *Basic Principles of Economics*, *op. cit.*, Vol. I, pp. 124–30; and for an analysis and further criticism of various "modern" modifications or overtones of it, see Vol. II, pp. 155–82, including footnotes.

preference overtones. What the low-income groups lack the means to buy, the higher-income groups *could* buy—and here we include "investing" in buying—and sometimes, for a decade or more, do buy. But when capital becomes plentiful and its "marginal efficiency" becomes relatively low, their buying (especially in the form of *investing*) is, in the Keynesian view, so greatly reduced by liquidity preference, as to bring about vast unemployment of the workers and even loss for themselves.

Like the Communist-Socialist leaders who have followed the Marxist-Leninist philosophy, Keynesians feel that the evil is fundamental to a free private enterprise system. Like these, they think of it as inherent in the general nature of the system and not to be explained by anything so "superficial" as monetary instability. Like these, they seem to believe that periodic breakdowns are "inevitable" unless and until there is substantially increased collectivism. And like these, they appear to have no interest in distinguishing between private income from capital brought into existence through individual saving and investment, and, on the other hand, income from being in a strategic position to charge others for *permission* to work on, to live on, and to draw subsoil deposits from, those parts of the earth which have become desirable because of geological forces and community development. Or, if they do have any such interest at all, they seem to be—at any rate Keynes seemed to be—*more* critical of private enjoyment of income from capital than of private enjoyment of the rent of land!

Could it be that the interest and support—often the enthusiastic support—of "the Keynesian revolution" in economics is to be explained (1) by its having avoided any admission that land-value taxation is in any way desirable, and (2) by its having coincided with a substantial, and world-wide, trend towards collectivism?

— 4 —

The Keynes-Hansen 'Demand for Labor' Notion

A Prosperity-Depression Theory by Which Labor Loses in Boom and in Slump

II

Tax Incentives for Saving and Investment

BUT THERE IS A WAY of dealing with the alleged independent and initiatory cause of depression envisaged by Keynes and Hansen—assuming it to *be* such a cause—which neither of these economists has apparently thought of. It is a method which would, at the very worst, give us a reprieve from the evil fate they warn us of. And even if we suppose that it could not, of itself, assure us of perpetual freedom from business depression and unemployment, it would provide enough gain to our economy to be very much worth while.

Both Hansen and Keynes emphasize as an important causative factor in the initiating of depression, a general unwillingness to invest. Keynes refers specifically to the inhibitory effect of liquidity preference when large investments in capital have brought the "marginal efficiency of capital" to a low percentage, *e.g.*, 2 or 2½ per cent. Hansen, as we have seen, regards large increase of population as a stimulus to investment, and decrease or unusually slow increase of population as retarding investment. Hansen must be assumed, therefore, to have a low "marginal efficiency of capital" in mind, in the latter case, as the proximate cause of the lack of new investment, a lack which, in his thinking, brings business depression.

But the returns which motivate investors are the returns they anticipate will come to *them*. It is not the per cent "marginal efficiency of capital" in adding to output which concerns them, but the per cent which comes to them personally. In other words, they invest for what is *left* after the yield of capital has been tapped by the community or state for the public exchequer. When Hansen says that *population* has *not increased enough* to make additional *capital* seem worth constructing and when Keynes says that *capital has increased* so *much* that its "marginal efficiency" is too low to overcome "liquidity preference," they *must both* have in mind a sequential small yield to investors. *And this percentage of yield would be much larger if captal were not taxed.*

If, therefore, we were to untax capital and draw sufficient additional revenue to make up the loss, by heavier taxes on the geologically-produced and community-produced value of land, this would *certainly* provide a greater reward to those who save and invest in capital. If it is really true—as both Keynes and Hansen contend—that the lack of an adequate gain

on investment leads to business depression and unemployment, and if by such a change in tax policy we can decidedly increase that gain, *what are the overriding arguments against our doing so?*

On the theory that it could, just conceivably, come about in some later decade or generation or century, that the return on capital to investors—even though untaxed—would be so low as to greatly increase liquidity preference and thereby initiate depression, such depression would still not be inevitable. An appropriate monetary policy could both satisfy—satiate, if necessary—liquidity preference, and provide enough additional purchasing medium to maintain the demand for goods and labor.

The change in tax policy here suggested would yield definite and substantial benefits, even though not needed at all to give us a reprieve from any depression generated in the way or ways Hansen and Keynes describe. The heavier tax on community-produced land values would lessen the waste of holding good land out of use for speculation, as it has lessened such waste in parts of Australia where such a tax system is employed. Labor would be better supplied with land, the productivity of labor would be greater and real wages would be higher. With lower land rent, the cost of housing to tenants would be lower.

Both cogent theory and available statistical data from Australia indicate that the larger percentage of gain to investors in new capital would bring about more capital construction in the communities, states and nations where this tax policy was followed. Thus, labor in them would be better provided with capital as well as better provided with land. For this reason too, then, the productivity of labor would be greater and wages would be higher.

Why should not followers of Hansen and Keynes join in urging this reform? On the basis of *their explanations* of how business depressions are or may be brought about, such a tax policy would be a definite help in preventing them—or, at worst, delaying them. On the basis of *their own hypotheses,* it would offer threatened humanity at least a reprieve and perhaps a long—even an indefinitely long!—reprieve. *Why* do they ignore it? Do some of them fear, perhaps, that to express approval of a land-value-tax policy might make them professionally déclassé? Or has it really never occurred to any of them that the possibility of land-value taxation has any bearing whatever on the adequacy or the correctness of the Keynes-Hansen analysis?

— 5 —

Land Value Taxation and the Rights of Property

I

HIGH LAND VALUE TAXATION tends to force good land into use and thus to make the rent of land lower. It offers more incentive to saving and to investment in the production of useful capital. It encourages increase of capital in the land-value-tax communities. It thus better provides labor with both land and capital, thereby makes labor more productive and tends toward higher wages. It lowers the expense of housing for those who must be tenants and lowers the sale prices of homes for would-be home owners. It makes easier, because less expensive, the providing of children's playgrounds and public parks.

Of course landowners, purely *as landowners,* have to pay higher taxes in the jurisdictions where land value is taxed more heavily and where the capital that men make is not taxed. But those among them—the majority—who own capital as well as land, are largely compensated and may, in many cases, enjoy a sizable net advantage, because their improvements and other capital are not taxed at all.

If it is contended that the owners of vacant land would, in general, suffer a net loss from the adoption of a land value tax system, it can also be said that the holding of good land out of use brings increased cost of housing, increased congestion and economic loss to the community. Can we effectively prevent the waste and loss from this speculative holding, if we insist that neither through our tax system nor in any other way must we visit upon those who thus hold land from use, any significant penalty?

It is possible, however, that advantage will sometimes accrue from the adoption of a land value tax policy in a city, county or state, *even* to an owner of a vacant lot who has no improvements on it at all and has been hitherto impeding the growth and development of the community by holding it out of use. For the removal of taxation from improvements and all other capital means that the net per cent income from improvements and other capital in that community compared with the net income they yield in communities still operating under the old system, will be, at least for a time, definitely higher.

To illustrate, suppose that the yield from capital (before subtracting taxes) has been averaging 8 per cent and that the tax on it has taken 3 per cent, leaving only 5 per cent to the investor. But now capital in the land value tax community is no longer taxed and owners who improve their land can hope to receive the entire 8 per cent. But investors in commu-

nities where capital is still being taxed as before, can hope to make only 5 per cent after taxes; and for the most part they are not likely to recognize quickly the better opportunities suddenly opened in the land value tax community. (How can they be expected to recognize such facts quickly if their economists have never called attention to the probabilities and if they have heard mostly the propaganda against this tax reform? A young graduate student at a mid-west university whom I met only recently, told me of his being warned by one of his economics professors to give up his sympathetic interest in it or "you'll only blackball yourself.") Hence our vacant landowner in the community which has now adopted the land value tax policy, if he cannot himself save enough to improve his land, may borrow at 5 per cent or not much over 5 per cent, from someone living where the old tax system is still in effect and to whom anything *over* 5 per cent looks *really* good.

III

4. Assuming a time honored system of exploitation of some by others—whether by monopolists, by slave owners, *or* by owners of the earth who can charge others for *permission* to work on it and to live on it—just how *can* such exploitation be ended except by taking *something* away from *somebody* and thereby causing "society" to be guilty of "a violation of good faith?" Consider, for example, the abolition of slavery. If the slaves are freed by an emancipation proclamation, has not "society" violated "its" implied "pledge" to their owners? And *if* these owners are fully *compensated,* must not others be taxed *extra* to provide the compensation; and could not *these others* fairly contend that "society" has violated "its" implied "pledge"—based also on long custom—not to take income or property *from them* in order to compensate slave owners? Or should the slave owners be, indeed, compensated, but only by making the *slaves* pay them the compensation,—*i. e.,* by making the slaves *buy* their freedom?

Analogously, how about compensation to *owners of the earth* who are in a strategic position to make others pay them for their *permission* to work on and to live on the earth, in those locations made desirable by *geological forces* and by *community growth and development,* and to draw from the earth subsoil deposits? If this condition is ended by the adoption of a land value tax policy, those who argue for "compensation" to the to-be-henceforth more heavily taxed landowners, certainly do *not* get to the *heart* of the question when they assert that "society" should provide such compensation. Inquiry is needed as regards just *who* should or would provide it. Insofar as landowners do not themselves provide for their own compensation by (collectively) paying from one pocket into another, the

compensation must be provided by the victims of the landlord system. Victims? Why? Because this system has *reduced* their net income from capital the existence of which their thrift has made possible, *lowered* their wages, *made harder* the transition from tenancy to ownership, and *increased* rents and congestion. To say glibly that "society" must provide compensation is to *avoid facing* the question of *just who* would have to provide it and whether the *victims* of the landlord system would have to provide much, or most, or all of it. If the *victims* provided *less than all,* would not the Walker view have to be that there had been "injustice," "villainy," and "a violation of good faith" towards landowners? Why do so many of the teachers of economics and the authors of economics textbooks *completely ignore* such considerations?

There is cogent theoretical analysis relative to the effects of a land value tax system on housing, on tenancy, on wages and on the economy in general. There are impressive inductive (statistical) data on much of this, comparable to the evidence from a controlled experiment in medicine, such as the recent experiment to test the efficacy of the Salk vaccine.

But these advantages of increased reliance on land value taxation are not obvious even to those who would gain the most from them.

There is need of leaders who can and do understand, or else these advantages will *never* be realized. Without such understanding, whatever changes do come are likely to be in a wrong direction, as has happened during this century over a considerable part of the world. And where shall we get these leaders if the colleges will not help? Where shall we get them if some of the textbooks most widely adopted and which are recommended by professors whom the publishers quote in their advertising circulars, as "distinguished," "superb," etc., fail to mention that anyone, anywhere, at any time has even suggested any steps in this direction?[10] And where shall we get our leaders if other widely used textbooks continue to impress on the minds of the students who read them, the idea that any plan or proposal to work for this really promising reform must be rejected as "unethical"—yet never so much as hint at a single one of the objections to this view which have been presented herein?

[10] Among very recent textbooks to which this comment is applicable are George Leland Bach, *Economics, an Introduction to Analysis and Policy,* Englewood Cliffs, N. J., Prentice-Hall, 1954,—also second edition, 1957; and Burns, Neal and Watson, *Modern Economics,* second ed., New York, Harcourt, 1953.

In contrast with these—as also with the other textbooks referred to in this chapter—is the presentation by Mitchell, Murad, Berkowitz and Bagley in *Economics: Experience & Analysis,* New York, William Sloane Associates, 1950, pp. 457–65. *Cf.* Bye and Hewett, *The Economic Process, its Principles and Problems,* New York, Appleton-Century-Crofts, 1952, pp. 684–7.

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