

'Economic Illiteracy'

LAUHLIN CURRIE was an early advocate of treating housing as a "leading sector" in the advance of under-developed economies. This was a rational proposal that was vulnerable to one fatal consequence: success incubates a self-destructing mechanism.

Under the property laws and tax regime employed by market economies, accelerated growth in construction encourages speculation in land to the point where growing incomes are channelled into the creation of a real estate bubble, which is foredoomed to implode and shatter the economy.

The negative impact of the land market is excluded from computation by economists, but there is no mystery about the theory. Lauchlin Currie described the problem in a background paper which he prepared for Habitat, the UN Conference on Human Settlements, in 1976. He wrote: "It is a striking example of our economic illiteracy that we have more or less quietly acquiesced in the private appropriation of socially created gains, letting fortunate owners and their heirs levy tribute or claim a share of the national income to which they have contributed nothing".

The case for capturing "all or a large portion of the pure monopoly gain of rising urban land has been impaired by failure to distinguish between land and capital in general, between land and building, and between the rise reflecting inflation and that traceable to pure scarcity".

Currie proposed the capture of 75% of the stream of income going to land for reinvestment in public infrastructure to support the private sector's capacity to produce wealth. This fiscal policy follows logically from pure theory. Currie noted that capturing rental income does not distort the use to which land is put: it is the neutral tool for raising public revenue and for disciplining the land market to serve the interests of

everyone. Without this policy, as happened in Bogota, Colombia, urban expansion generates huge increases in land values which "will largely accrue to a relatively few and be a prolific source of large fortunes".

By treating rent as public revenue the state plays its part in providing incentives to work and a balanced growth in the urban environment, including a reduction in the costs of commuting and the conservation of green fields.



Lauchlin Currie (right) with Misael Pastrana, President of Colombia (1970-74) and father of the present president, Andres Pastrana.

The policy was also necessary on moral grounds. Currie explained: "The rise in land values (and, to a small extent, building) that results from the growth in numbers and income of a community is a reflection of pure scarcity. It arises from the community and should belong to the community. It does not in any way arise from the work or saving of an individual owner and does not provide any incentive to work or save, since the supply of land is fixed."*

* Lauchlin Currie, "Controlling land use: the key to urbanization", *Ekistics*, 244, March 1976, pp.137-143.

working people, it was important to correctly define the public sector's role. In essence, this entailed the removal of taxes on wages and the profits from trade, and collecting revenue for the state from the net income of society - the rent of land. Their Scottish contemporaries, notably Adam Smith and William Ogilvie, concurred.

This crucial insight was largely ignored by governments, which from the 1790s chose to burden labour and capital with taxes. The outcome was predictable. Taxation has the effect of disintegration, causing

▣ micro-economic failures: people are priced out of work, for example, because employers cannot afford payroll taxes on

top of wages; and

▣ macro-economic failures: government failure to collect rents generated by public investment influences investment in favour of land speculation, which prices entrepreneurs out of business.

This explains why governments could not maintain equilibrium in the 19th century industrial economy: they pursued policies that had the opposite effect! Even so, the theoretical concepts were related to the real world. People were located on land, and they used their labour in conjunction with capital to produce wealth. All policy options remained open.

Then, at the beginning of the 20th century, something remarkable happened:

economics was systematically detached from reality.

An explanation has been advanced by a professor of economics from the University of California. Mason Gaffney argues that the neo-classical school took root to neutralise the progressive politicians who were making a serious attempt to capture socially-created rent for the public purse. One technique used by leading economists in the US and Britain was to vaporize the concept of land: it was subsumed into the category of capital, done away with as a special factor with its distinctive internal logic. This closing of people's minds helped to ensure that publicly-created rent remained in private pockets.

▣ Gaffney's thesis explains why governments seeking to restore the economic 'parts' to their proper place after a boom/bust persistently fail. Taxis was thwarted by taxes and taxonomy.

▣ If Gaffney's thesis is correct, modern economists may have a lot to answer for. Are they prevented from wrapping their subject-matter into a unified theory because of the recalcitrance of unpredictable people? Or because of a wilful failure to conform to the requirements of empirical science?

Consistent with Gaffney's thesis, we need to note the curious exception to the regressive detachment of economics from reality. According to Nobel laureate Leontief, agricultural economists continued to locate their work in the real world (see Box 1, p.5).

THE NEO-classical school dominated the first half of the 20th century. Helpless governments were perplexed by the Great Depression of the '30s, but economics was not to blame. Economists could propose policies for rescuing the markets. The fate that befell one of them illuminates the way universities supported by grants from the major rent-appropriators manipulated the social science for private benefit.

Canadian-born Lauchlin Currie (1902-94) argued that, by applying scientifically valid principles, it was possible to fashion tools that would help government to haul the US out of the depression. The price he paid for his independent turn of mind was high. Currie lost favour at Harvard University, where he was teaching, because he proposed an increase in public spending.

He was to be rescued by his competence as an economist. He moved to Washington, where he was to become the architect of the Federal Reserve Bank as the first true central bank of the US. He was also to become the first professional economic advisor to the White House: he was appointed by Franklin D. Roosevelt in 1939. He played a leading role in the Lend-Lease programme to China during the Second World War, but fell victim to McCarthyism when he was falsely accused of being a Soviet spy.

Currie devoted the last 40 years of his life to helping developing countries. One of his