The Henry George Theorem and the Entrepreneurial Process: Turning Henry George on his Head

By LAURENCE S. MOSS

ABSTRACT. This chapter offers an interpretation of the Henry George Theorem (HGT) that brings it squarely into the study and analysis of entrepreneurship somewhat loosening its ties to the subfield of urban economics. I draw on the pioneering work of Spencer Heath whose insights about the viability of proprietary communities were developed further by his grandson, Spencer Heath MacCallum who, in 1970, recognized that private real estate developers sometimes make their capital gains (mostly) by creating useful public spaces that others enjoy. I also draw inspiration from Fred Foldvary's effort in 1994 to synthesize the pubic goods problem in economics with the Henry George Theorem in urban economics. While the real estate owner—developer does emerge on my pages in a somewhat more favourable light than as originally portrayed by Henry George in his *Progress and Poverty* in 1879, I offer a realistic appraisal of the duplicitous behaviours required of such entrepreneurs. in the context of the modern regulatory state. Real estate development remains a 'hot button' item in local politics, and real estate developers must become genuine 'political entrepreneurs' if they are to complete their projects in a timely way and capture business profits. It is a complicated story that the HGT helps make intelligible in terms of human action.

I

Introduction

There is hardly a major real estate developer who does not understand the basic mechanisms of the Henry George Theorem (HGT). Even the

This article was first published in *Henry George's Legacy in Economic Thought*. ed. John Laurent (Cheltenham, UK: Edward Elgar Publishing, 2005), 148–165. Reprinted with permission of Edward Elgar Publishing Limited, Cheltenham, UK and Northampton, MA.

American Journal of Economics and Sociology, Vol. 69, No. 1 (January, 2010).

real estate *brokers* who earn commissions know that when it comes to valuing some parcel of land, it is the location of that parcel that drives a major part of its market value. By location they mean proximity to schools, fire departments and, most importantly, to central business districts (CBDs). It is a brute fact about the real world that 'economic activity tends to concentrate geographically' (Hanson 2000: 477; Scott 2005). An agglomeration of activity attracts large numbers of people to that area.

In Massachusetts, U.S.A., there are no fewer than 350 towns and cites. Each has its own CBD and sometimes several. Also, each town or city has its own local government, fire service department, police, schools and the myriad licensing departments that provide public access to the otherwise private plans and goals of the local real estate developers.

Homeowners know in their bones that a successful 'improvement', such as an elegant pedestrian mall lit by modern street lamps and designed by a noted architect, will bring higher resale values for their homes. They also know that such improvements are costly and must be paid for somehow. They worry that future real estate assessments (and later taxes) will rise.[1] Local business owners know that a tasteful lit market place with ample parking access translates mightily into large sales and profits. There is nothing that piques a local community's interest more than a real estate deal just a block or two from its homes and businesses.

These financial implications, coupled with a genuine interest in their community and what they leave behind for the next generation, make local town politics important to many people.

I am tempted to write that, just as 'all politics is local,' all local politics involves real estate deals, but that would be overstating matters a great deal. The famed economist Joseph Schumpeter noted in 1911 that economic development involved novelty. New combinations of commodities pioneered by energetic entrepreneurs and subsequently adopted by hoards of imitators are what characterized the entrepreneurial process (Schumpeter 1961 [1911]: 65–68). Schumpeter would. have included under his label 'new combinations' different combinations of product characteristics under brand names, and a great many other activities as well. Reflecting the colonial venturing of his day, Schumpeter included the discovery of new resources and materials and the structural organization or reorganization of industry as examples of 'new combinations'. He did not mention real estate but I think that when the real estate developers pioneer new combinations of property rights they are quintessential entrepreneurs in Schumpeter's sense of the term.

The purpose of this chapter is to make a case for the importance of the HGT, not only as an abstract theorem in urban economics (which it most certainly is), but also as a catalyst in the 'story-telling' that is an essential part of understanding the entrepreneurial process. The implications of the HGT are used to help illuminate patterns of behaviour that are observable in the market place, in the local community, and in real estate markets where claims to real property are traded under competitive conditions. In my view, the whole purpose of economic reasoning is to make the world understandable in terms of human action. As with many, if not all, economic models, the point of the exercise is to provide the social scientist with basic insights about processes at work in the real world. The theorem itself, as I shall explain in section 4 below, can help focus the mind on characteristics and features of the entrepreneurial process around us. In the next section, I shall say something about the historical Henry George, who did not hold real estate owners in high regard. While he did praise those who invested and improved land, he thought that many developers were 'mere land speculators' offering nothing of value to the whole of society.

II

The Historical Henry George

The life and times of Henry George are important topics for historians of what is termed the 'progressive period' in American political life (Barker 1991). Recently, a four-volume collection of George's journalistic writings has been published and is testimony to the continuing interest among historians and admirers of this. giant of American politics and social reform (Wenzer 2003). George's best-known book was *Progress and Poverty* (1882) [1879], which is generally declared to be one of the 'best sellers' in the history of economics (Barker 1991 [1955]: 330).

Like Karl Marx only a decade or so before, George set out to change the world and not just intellectualize about it or assign names to patterns of behaviour around him. He remarked about how social advancement could take place in any given territorial area while in that same area so many others endured abject poverty. The problem was to explain the uneven nature of economic development. His own experience in the American West with the land speculation bubbles convinced him that an important segment of American society was growing rich without having to do any work at all. This wealthy segment of the United States gained wealth by virtue of the fact that they owned land in strategic locations, often near 'central business districts'. As the population grew and individuals competed to live within close proximity of those CBDs, the 'idle' landowners became richer and richer. They raked in large rents and real estate gains at the expense of the needy and downtrodden.

Most important to George was that these real estate gains (allegedly) bore no relationship whatsoever to any hard-laboured-for improvements on that land. Some portion of the gain from real estate ownership was entirely independent of the landowners' efforts; that portion of the land value, following David Ricardo and the terminology of the older classical school of economics, George named 'rent'. Rent was that portion of a market-generated return on the sale or leasing of an item that was above the minimum amount that was needed for the owner of that item to provide it in the first place. In a wealth-maximizing world, economists write of the 'opportunity cost' of that item, by which they mean the amount of rental income it can earn in its next-best application. So in the case of real estate, urban rents are sometimes defined as that portion of the rental value above what that same land might earn if it were applied to agriculture.

George was one of the small group of prominent economic writers at the end of the 19th Century who insisted on distinguishing land from other forms of capital goods. The tendency of his time, and still today, is to abstract from the locational and other attributes of a parcel of land and lump the land along with machines and even intellectual property as 'capital goods' that are valued at their present actuarial value (Fisher 2003 [1906]: 56). According to George and his followers, the returns to land are governed by vastly different economic causes than, say, the return on a machine or what is today called human capital.

Machines can be reverse-engineered and replicated, no matter how intricate or complicated they may be. Even a patented machine can be licensed and reproduced. Not so with land. Land is entirely different. It has a fixed spatial location, and one parcel of land is distinguished from all other parcels by its location. In the context of urban development, there are few other land sites with *exactly* the same location with respect to the CBD. There are substitute locations, and possibly close substitute locations, but there can never be an exact match. In a nutshell, this means that to own land is to own a particular geographical location for which there are few substitute locations. Landowners are the ultimate monopolists since they possess the exclusive rights to a unique and distinct location; in addition, the law permits them to lease some or all those rights to others not so privileged for rents.

Now with the progress of society (and this includes the growth of population flocking to urban areas), some of the landowners will rake in huge rents. These 'differential rents' are those in excess of the rents needed to cover lost opportunities and the amortized charges needed to recover the funds used for landed improvements and investments. Some sort of pure *unearned* surplus accrues. Furthermore, land speculators whose only activity is to keep land from being productively employed reap gains as if being rewarded for their antisocial behaviours. Another alleged result of this behaviour is that the wages of labour remain much lower than they would be in an economy that rewards labour according to its productivity. George's characterization of the parasitic landowners was and remains grist for the mill of radical reformers around the world.

For George, the moral or normative question was as important as the economic mechanisms. Why should a monopolist be allowed to keep his or her 'unearned' gains when the poverty of so many others could be mitigated if only the landowners were forced to share their windfalls with the rest of society? Who gained more from government than the landowners? Did fairness and justice require that the landowner give up his unjust enrichments so that others could live better? George concluded that such redistributions were required. He advocated taxing away the portion of land rent paid for the unimproved value of land—that portion of the rent that was not due to betterments or improvements made to the land. George reasoned that since the tax he advocated was on something entirely 'unearned', it would have little or no effect on incentives to supply land in the first place. There would be no reduction in the amount of land in the economy since land was fixed (or inelastic) in supply. I should also remark, perhaps with the qualification of 'last but not least', that the land-value tax is considered by most Georgists to be 'just' and fair.

And there was more good news. If the land-value tax were substituted for the myriad other taxes currently imposed on the community, the net effect would be a surge in productivity and investments. To tax is to discourage. So, if the land-value tax were substituted for the income tax, the labourer would have an incentive to work longer and harder, to the benefit of himself and the entire community.

George was not the first to call for a land tax in the history of economics, but he was one of the first to call for a tax that might replace all other taxes. This ingenious and easy-to-explain program of what others called the 'single tax movement' spawned a political movement of spirited 'single taxers'. Single taxers are still active today and they always attract a few ardent followers. In fact, the single tax movement sparked global interest; many tax jurisdictions today still rely in part on a laud-value tax based on Georgist influence and analysis (Andelson 2000). In the United States there were a half a dozen or so 'Henry George schools' that offered public lectures and provoked interest in radical land reform ideas. Currently several schools are still operating.

The HGT was not mentioned by Henry George, and it was not directly stated in any of George's major writings. The theorem was independently discovered by J. Serck-Hanson and D. A. Starrett in the early 1970s (Arnott et al. 1977: 336). The logic of the approach directly flows out of the seminal work of Harold Hotelling and William Vickrey both of whom (most interestingly) were aware of, and influenced by, George's writings (Hotelling 1938; Vickrey 1977). Still, the theorem is not really about politics and political reform. Instead, it is about patterns of economic development and how a benevolent city planner might manage a tax-spending policy that would raise living standards for all those residing in a given urban area or else planning to move into that neighbourhood.[2]

The HGT describes an equilibrium where the total utility in a region is at a maximum when an optimal population has moved to the neighbourhood of a CBD. A scientifically engineered land-value tax can be levied to finance the infrastructure improvements that provide those same taxed individuals with the financial means to pay the tax. The HGT is an *abstract proposition* that supposes an ideal benevolent government apparatus, in that there are no invisibles or unknowns and all government administrators look out for the public interest and not their own private selfish interests.

As a theorem that comes out of the armchair theorizing of modern economic analysis, it is as much fiction as are most *abstract* models in the social sciences. And as an abstract model, its value is not in the *description* of everyday life in urban settings, but as a foil or 'equilibrium apparatus' against which we can detect actual tendencies or patterns at work in the real world of everyday political life. It is to this modem apparatus—the apparatus of the HGT—that we now turn our attention.

III

Private and Public Goods

It is customary in introductory economics courses to explain why government intervention is needed in order to make ordinary everyday life both possible and wholesome. It is generally agreed among economists that an anarchist society (a society without a modern state, claiming a monopoly of coercive power in a territorial area) cannot possibly provide the stability and security that many of us enjoy under modern political arrangements. Part of the argument for centralization has to do with so-called 'public goods'.

Public goods provide 'positive externalities' to others in the community. For this reason they are typically undersupplied by private entrepreneurs because entrepreneurs cannot figure out a way of excluding those who have not paid from enjoying some of the benefits of these goods. Others in the community seeing the 'free riders' will also refuse to pay for the public goods. That is why a modern tax state is needed: to supply or at least subsidize the production of so-called 'public goods and services'; an example might be education. It is alleged that a literate community provides greater stability and social harmony throughout the community than if matters were left entirely to the families concerning how and whether children are to be educated and trained. Free market *laissez-faire*—so the argument for government goes—would undersupply education.

And then there are the 'negative externalities', which similarly require coercive intervention by a taxing state to mitigate certain harms. An example might be contagious diseases, which need to be bottled up by isolating the carriers in hospitals or even detention centres (Fuchs 2005). I believe that I have offered a fair and accurate summary of the conventional wisdom in textbook education.

A public good or service (hereinafter, simply 'public good') is often sharply contrasted with a private good. Consider the simple example of an apple. An apple is a private good because, when appropriated by any member of the community, it can be entirely consumed by that member and only that member. When Joe eats the apple, Janet and Alice and Bill cannot at the same time also eat that same apple if Joe does not allow them to do so. Such a good—the apple—is a private good because the enjoyment of most of the apple's characteristics is a private affair. The image is the stereotypical one of neoclassical economics, in which each individual maximizes his own private utility by appropriating through market transactions an optimal combination of goods and services.

Joe's consumption activities to obtain dominion over goods and services rival others' attempts to do the same. Apple consumption in the community is an example of 'rivalrous consumption'. Joe, Janet, Alice and Bill do not end up struggling over the apple because they all respect the law, which provides them with a simple way of deciding who 'owns' that apple and therefore can consume it. In a political community where property rights are well defined, and when Joe acquires his apple in a lawful manner, he can lawfully exclude Janet, Alice and Bill from the enjoyment of that apple. In other words, the consumption of the apple is (often) an excludable activity. Rivalry and excludability are the defining characteristics of private goods (compare Foldvary 1994: 14).

According to the story that is so often told, it is the existence of public goods in any specific location that makes the consumption of private goods at all possible. The organizations and institutions that constitute the system of 'law and order' together constitute an example of what is often termed 'public good'. Despite the long and well-established history of private decentralized efforts to provide these valuable services, the textbooks insist that only a coercive tax state can effectively provide the vital service of defining and securing private property. The historical evidence suggests that private sector developments may also be responsible for many so-called public goods, but the conventional texts do not mention this at all (Bairoch 1988 [1985]).

There is a sense in which 'civility' and some aspects of a well-functioning rule of law are not only non-rivalrous, but non-excludable as well. Surely it is much more economical to do business in a region characterized by trust, basic promise-keeping and civility? This combination of background conditions, or what some writers term 'social capital,' is often a major factor in explaining the strong economic performance of certain geographical regions of the world (Putnam 1993; Asheim 2000). Certainly these activities employ labour in the form of judges, attorneys, notaries and sheriffs and capital goods in the forms of court houses, recording offices and jails. But most importantly, when functioning well they contribute to a radical reduction in transaction costs and facilitate trade and exchange. The importance of well-defined property rights and their protection has long been a basic precondition for the successful operation of the market system. The presence of such institutions is the key to rising living standards in any region. Law and order allow an extended division of labour and knowledge and encourage the long-term planning horizons of capitalist–entrepreneurs.

The CBD shall serve as our shorthand device for that geographical space in which humans gather to trade and exchange whether it be apples, labour services or information about new technologies. Now some CBDs have evolved from early trading centres and fairs—there is a valuable and insightful literature on the city and its development that is rich in insights and illuminates important milestones in this evolution (Henderson 1988; Bairoch 1988 [1985]). Other CBDs are the result of conscious human planning and sometimes resemble the work of all-knowing benevolent central planners. I have in mind here the world of real estate entrepreneurs, who sometimes create CBDs as a means of accumulating wealth and profits.

Real estate developers have crafted viable shopping malls, industrial parks, medical centres, movie theatre complexes, retirement communities and hotel/resort areas. To these significant achievements, I add the creation of trade shows and 'exhibits', which create a public space in which information can be exchanged along with handshakes and promises. Trade show entrepreneurs often provide hotel space and food services. In all these cases, the revenue from the sale or leasing of private goods helps pay for the so-called public goods.

The public goods include large and luxurious common areas set up with the conveniences conducive to business discussion and contract formation. Professional associations are managed to provide 'job markets' and informational exchanges. Even in traditional towns and cities, city planners are busy at work beautifying malls with lights, parking areas, music, security guards and other protection services, and, in some cases, even mosquito-catching machines to provide a wonderful atmosphere for shopping or just 'hanging out'. Rest rooms and places for parents to tend to infants and young children are provided as well. During the holiday seasons, popular displays of religious themes are often crowd pleasers. Public goods all, provided for business reasons.

Any pedestrian can enjoy the public display so long as he or she can get in close proximity; one person's enjoyment of the overall ambience and splendid beauty of the area does not *significantly* reduce another person's similar enjoyments—at least, not up to a point. The benefits are there for the taking, but always only to a certain limit. Beyond some point, congestion sets in and one person's enjoyment reduces the enjoyment of others.

But until that point has been reached, Joe, Janet, Alice and Bill can mutually enjoy certain comforts and we have a non-rivalrous business activity. Furthermore, one person's enjoyment may not seriously interfere with another's, within broad limits, and certainly if one person is lawfully in the area, another by definition cannot choose to exclude him or her. Non-rivalrousness, and to some extent non-excludability, seem to be dramatically different in this case from the one I presented earlier concerning consuming the apple. Indeed, in this case we have the *private* provision of *public* goods and services. This wasn't supposed to happen!

IV

The Henry George Theorem

And there is more to the story. The average cost of providing amenities to the CBD and other public spaces often falls as more people are allowed to congregate at the CBD. This phenomenon has a long history in economics and may be referred to as the 'scale economies' phenomenon. Falling costs are not so much the result of any subtle economic analysis as they are simple arithmetic. As you divide any given expenditure on a public good by a larger divisor, the per capita or average amount that it costs falls. It is also a mathematical fact that if the average cost of providing any public good or service falls (as when the population increases in a given territorial area), the marginal or incremental cost must be *below* that level of average cost (Hotelling 1990 [1938]).

Consider this example. Suppose a town planner or enterprising entrepreneur has provided a large, well-lit open public space with convenient rest rooms and insect-repelling technologies. The marginal cost of providing this bundle of services to one more individual may be tiny, even close to zero. Now, economic efficiency *requires* that when something is priced, the price should reflect the marginal cost of production. But this means that the provider of these public goods and services must give them away either for free or for some ridiculously low price. At this low price, there will not be enough operating revenue to cover the total costs of providing the public goods and services in the first place (Hotelling 1990 [1938]).

What a sad state of affairs the provider of public goods finds himself in. Competition among suppliers will drive the price down to zero, and this will produce losses for all. The textbook remedy is government intervention, through its powerful tax authority to bolster or remedy this alleged 'market failure' and make certain that the public goods are provided in the right amounts. A tall order indeed.

The great insight of the HGT is that government intervention may not be needed at all. One person's 'market failure' can often be another person's key towards entrepreneurial discovery. In this way there need not be as much government involvement other than providing the minimal rule of law within which all trading occurs.

My analysis adopts Fred Foldvary's important observation that most public goods and services are intimately connected with territory in some essential way (Foldvary 1994: 25–43). You cannot enjoy the ambience and convenience of the shopping mall's food court unless you find a way to come onto the grounds where the food court is located. Public goods are nearly always provided in a given territorial area. In addition, the size of the benefit you receive from the public good often varies in a noticeable way depending on how far away you are from the CBD. Often, the closer you are the greater the benefits and/or the more frequently you can enjoy those benefits. This creates a premium for proximity to the attractive features of the CBD.

The closer one lives to the CBD the lower the transportation costs of going to work each day and participating in valuable information networks from which so much career advancement is possible. In the case of any complex urban environment, those individuals who make their livelihood in the CBD, and have the highest opportunity costs of time, will pay the highest prices for housing. One thinks of a surgeon trying to get to the operating room in the early rush hour period or an attorney hastening to court in order not to disappoint a desperate client.

Those living farther away from the CBD will have to incur larger travelling expenses, but, on the other hand, they will enjoy either more spacious housing or a given amount of housing at significantly lower rents. If the housing market were competitive, rents and real estate values would rise in the vicinity of the CBD. Although housing desirability is a complex bundle of characteristics that includes, but surely is not limited to, proximity to the CBD, there is a tendency for a gradient of real estate prices to form. Locations most proximate to the CBD rent for the highest rents and those farthest away at lowest prices (Mills and Hamilton 1994: 132–143). This is the 'differential rent' phenomenon that fascinated Henry George and the classical school economists that preceded him.

The ghost of Henry George's economics haunts these discussions. Those who invest the resources to create the CBD may not be the same group that enjoys the benefits. Then again, what is to stop real estate entrepreneurs from both creating a CBD and profiting from the expected run-up in real estate values?

Wouldn't the expectation of enhanced land values be an obvious inducement for real estate venturers? Get options on the land nearest to the CBD, and then make those options more valuable by constructing a CBD. Can one calculate the cost of the public goods provision and compare that with the expected net land-value appreciation? Under what circumstances will one just balance out or equal the other?

The HGT is all about modelling this balance. It holds that under certain conditions the difference between the total costs of providing some public goods and services *at their efficient levels*, and the revenues that can be received from pricing those goods and services at their marginal costs (which may in fact be zero), will just match and equal the total differential rents generated by those activities on the surrounding properties. This implies that it may be feasible for private entrepreneurs to supply public goods in the form of CBDs if they can tap into the capital gains by purchasing enough of the nearby real estate at economic prices.[3]

The HGT is typically presented in the context of urban economics: a public official trying to decide how large he or she should let the city grow. If the offical wishes to maximize total utility in the region, how large a population should be invited to emigrate into the area? The challenge is engineering the optimal number of people in a given geographical area and managing that area so as not to exceed that optimal number. Richard Arnott's presentation of the theorem, rooted in the pioneering writings of Harold Hotelling, William Vickrey and Joseph Stiglitz, has this focus. Arnott's discussion is about managing a region in order to achieve an 'optimal' city size in terms of individuals living in that geographical area. According to Arnott:

> The basic Henry George Theorem states that, in an arbitrarily large, spatially homogeneous economy [that is, the residential land parcels are equal in size and identical in other ways except for location to the CBD] composed of identical individuals, in which the single source of decreasing returns to scale is the production of lots via commuting costs, labour is the only factor of production, and the distribution of economic activity over space is nontrivial, optimal city size is well defined and is characterized by

aggregate land rents equaling expenditure on the pure local public good (Arnott 2004: 1085).

Here in a nutshell we have the idea that the sum of the land rents generated by the attractive CBD is just enough to finance the construction and sustained maintenance of that CBD.

Arnott suggests that one of the novel but practical applications of the HGT has been to decide whether existing urban areas, like the city of Tokyo, are really overpopulated, as some commentators contend. Alternatively, does it still have ample room to grow larger? The research team of Y. Kanemoto, T. Ohkawara and T. Suzuki has concluded that 'Tokyo is not too large [at all]' (cited in Arnott 2004: 1082). Tokyo is not too large because the benefits received by people living there still exceed on the margin the additional transportation and rental expenses associated with moving to the CBD.

But the HGT is destined for other uses besides informing the work of benevolent city planners, as I show in the next section below.

V

The Benevolent Central Planner Debunked

As we have seen in Arnott's paper cited above, there is no *logical* reason why a *benevolent* central planner cannot draw his or her insights from the HGT and design a well-meaning and bountiful downtown program of infrastructure improvements financed by an orderly growth in population and the enhanced value thus created. It would not surprise me at all if the recent torrent of urban growth in modern China produces great interest in the HGT on the part of the Ministry of Economics. The Ministry could use the theorem to argue how the Chinese Communist Party might better manage migration into the large cities in the eastern parts of China. It is possible in principle for a benevolent central planner armed with the HGT and committed to honesty and fair play to orchestrate a genuine situation of mutual advantage and gain.

Unfortunately, everyday street smarts informed by historical understanding suggest that what might happen in a fictional abstract world of angelic city officials will not happen in a world of guileful politicians and self-dealing managers. It will certainly not happen in China, where the corruption and insider trading of the Communist Party is notorious.[4] Even on the local levels of towns and cities in places such as Massachusetts, honest management by town officials is not something that anyone takes for granted, certainly not by real estate developers who often have to pay up or risk losing their projects midstream. Homeowners in the way of the bulldozer find that their property rights can sometimes be condemned under the eminent domain laws. These laws may be favoured by the real estate entrepreneurs, who get the locations they need at a reasonable price by buying the property title from the State after they have taken the title away from private persons (Peterson 2005: 25).

Those in charge of the basic infrastructure design, whether they are managers in the building department or the zoning commission officials, can promote their own private interests, often betraying the public trust. The HGT shows how, by making real estate purchases secretly and through trusted cohorts ('straws'), an insider can get wealthier through private 'capital gains' at the expense of the developers. Unlike Henry George's land speculators who get rich 'doing nothing', these speculators get rich doing quite a bit of political manoeuvring. Such manoeuvring is a hard day's work. Laymen join the process as well by attending town meetings and befriending licensing commissioners.They personify the 'rent seekers' that economists are fond of mentioning in related contexts (Tullock 1989).

Also, the costs of these projects—the projects whose expenditure will be divided among hordes of taxpayers—have an annoying tendency to rise. Each person has an interest in this not happening, but no single individual finds it financially worthwhile to expose the shenanigans associated with the award of contracts for the construction about to begin. Kickbacks, over-billing and a variety of 'tricks of the trade' now greet the weary real estate owner when dealing with the permitting processes involved. It seems unrealistic to expect any place in the urban economics literature for this topic; the abstract model of urban land use fails to account for the machinations and the dealings of everyday local politics. The potential gains of letting one property owner make the infrastructure improvements, many of which have that public goods character, while other property owners look on and capture the benefits, is a brute reality of modern administrative regulation. All successful real estate developers have to assume this risk and some way align their interests with those of the regulators if they expect to complete their projects.

VI

The Entrepreneurial Process

The HGT steers us towards a fuller appreciation of the work of the real estate developer in a modern regulatory environment. Still, there are some unsung heroes of the market process who somehow manage to provide public spaces where industry can agglomerate and shoppers can gather. The idea is to capture the enhanced value of the most proximate real estate by playing by the rules of the game. Surely, it must be a tricky business to make commitments and then avoid being held-up afterwards by the canny zoning commissioners or the building inspector who questions whether the regulations are being adhered to correctly. Also, those citizens at the town meetings often grasp the potential of well-situated property rights and act accordingly to make gains.

I should not be read as stating that the real estate developer is an innocent and the government official is the corrupt extortionist of capital gains. Where there is bribery, there are both those who give bribes and those who take them. It is the classic struggle over the gains from trade. Still, it is amazing how many great projects do get completed by the private entrepreneurs despite the many rent seekers who gang up against them.

From retirement communities to shopping malls, condominium developments, hotel complexes, trailer and industrial parks, public spaces come into existence. We appreciate the pioneering work of Spencer Heath MacCallum, who recognized this important feature of modern real estate development (MacCallum 1970). More recently, Foldvary extended MacCallum's work by recognizing the achievements of Walt Disney World, The Reston Association, Arden Village and others in the creative (but legal) financing of important communities and public spaces (Foldvary 1994: 114–193; see especially, Foldvary's explanation of how Spencer Heath MacCallum draws on the pioneering work of his grandfather, Spencer Heath). These examples suggest that this marvellous process of value creation at work is quite common and can be found in nearly every town and city where a private market in real estate exists and is allowed to function.

Consider a retirement community where the developer provides a golf course, swimming pool area, a myriad of sewage and water lines, communication cables, and so on, and a central club house with restaurant and stores. The profits come from the difference between the costs of the project and the sale of the residential and commercial properties associated with the project. The costs include the original purchase price(s) of the land, the improvements to the land, including the zoning changes and related variances that had to be petitioned down at the local town government, and the 'rents' extracted from the contractor by those connected directly or indirectly to the political process.

In this case, we have the provision of a 'public good' that is strictly tied in some way to 'location'. The good is largely non-rivalrous, but those most proximate to the public good hope to obtain the most sizeable benefits. The entrepreneur comes up with a novel combination of property rights that allows him or her to capture part of the value created by the project.

VII

Business Educators Largely Ignore the HGT

I doubt that an experienced real estate developer after reading this chapter would learn anything really new about the real world of local politics and strategic insider dealing. Indeed, even real estate brokers can figure out how combining property rights in new ways can create extra value in most residential communities, and many do in brokering deals. In Brookline, Massachusetts, where overnight parking on the public streets is illegal, a broker can enhance the value of any residential property by scouting out and obtaining an overnight parking space on another privately owned property. Reshuffling property rights in novel combinations and capturing value by so doing is, as we learned from Schumpter a century ago, the very heart of the entrepreneurial process.

What I find amazing is how little of the HGT and the insights it provides ever gets into the standard and ordinary curriculum of economics major programs or even entrepreneurial programs at colleges and universities. There is an unfortunate tendency to dismiss theoretical studies as too abstract for the training and enlightenment of business leaders (Mintzberg 2004).

Indeed, my own recent field trip to a major bookstore that contains about a score of books for sale on the general subject of 'making millions in real estate' found that, almost without exception, these texts fail to even mention how restructuring and recombining of property rights can be a major source of value creation in a market economy. One author insisted that 'most real estate books will tell you, the top three criteria for a property are: Location, Location, Location!', but nothing much seems to follow from this except that 'a good location . . . may be a subjective thing' (Roos 2005: 106). True, a good location may indeed be a subjective thing, and that is why investing resources to create an attractive centre at which valuable public goods and services are generated, while maintaining cash and control rights on proximate locations can be a lucrative business strategy.

Another immensely popular read by Tyler G. Hicks comes much closer to the issues and insights raised by the HGT when Hicks reminds his readers that 'towns and cities usually grow in population as time passes. This growing population needs space—that is, land. To satisfy the demand for more space, almost all communities expand horizontally' (Hicks 2000: 94). But the relevance of this important fact is left unexplained. The front cover of the book proclaims that over 300,000 copies [were] sold'. Perhaps Hicks and his colleagues are saving the insights of the HGT for an advanced course about how to make billions in real estate.

Both in the case of academic curriculum, and especially in the area of entrepreneurial studies in the business school environment, we find precious little about the HGT. Its related insights and dramatic examples remain largely undiscussed. Economics professors teach market structure analysis to business students, and the basic ideas of segmenting markets and price discrimination are taught as well. But the myopic focus on price theory neglects the economics of the

Schumpeterian entrepreneur in modem settings. It is tragic how so much of interest and importance gets left behind.

I can only speculate on what may have caused this black-out of the real politics of public goods provision by private sector entrepreneurs. Part of the problem stems from the unfortunate direction economic theory took after 1950. The geographical location of economic activity was largely ignored. Paul Krugman attributes this peculiar turn of events to a divergence in economics between the study of economic geography and the study of international trade theory (Krugman 2000: 49). He goes on to explain that the study of international trade theory does not in any way preclude the study of increasing returns, the agglomeration of industry and the enjoyment of public goods and services. Still, it is a matter of history that this literature did in fact ignore these remarkable phenomena. As a result, international trade theory in economics largely ignored the exciting problems of economic geography, such as explaining why certain industries cluster and real estate prices span out in particular ways. During the 1980s, developments in international trade theory took a turn for the better, and the 'New Trade Theory brought increasing returns, imperfect competition, and multiple equilibria firmly into the mainstream' (Krugman 2000: 49). While these developments were under way, the urban economic theorists explored the logic of the HGT but not with any eye towards practical applications in entrepreneurial studies.

VIII

Conclusion

I insist that the study of location—how a competitive real estate market allocates rights to location sometimes more efficiently than at other times and how market opportunities are created for brilliant entrepreneurial venturing when inefficiencies appear—remains an important and rich part of the story of modern capitalism. The capitalist process pushes through and works around the corruptions and 'politics' of local government. The HGT shows how public goods are deeply embedded for their enjoyment in territorial advantages and how with competitive real estate markets entrepreneurs can reshuffle and redefine those rights so as to produce mutual gains.

Consumers choose private goods in different contexts and in different ways. Sometimes they are customers in stores balancing the characteristics of products and services against each other; other times they are tenants and homeowners choosing where to live and work. The HGT is an essential part of the full story of entrepreneurial venturing in the 20th and 21st Centuries.

While it has earned a noteworthy place in the texts dealing with urban planning and city government management and taxation, the HGT is much more robust and applicable to broader issues about real estate development, as I have suggested in this chapter. I have also praised the entrepreneur—landowner for his or her foresight and ability to create value by recombining property rights and navigating the regulatory maze of modern urban life. Although I have recognized the practical reality of real estate developers having to obtain permits and variances, and to struggle with the selective enforcement of regulations until certain bribes have been made, I have not elevated the real estate developer into that iconic hero of modern capitalist enterprise that we sometimes find among political writers.

All I have done is follow the lead of MacCallum and others by turning Henry George on his head. Certainly, not all gains in real estate come from the brainless speculator holding onto land and scheming to keep it off the market. There is more to making capital gains than that. Speculation is an important and valuable part of the entrepreneurial process (Rothbard 2004: 1212–1214). In fact, the private provision of public goods, often in the form of CBDs, is one of the most stunning accomplishments of private entrepreneurs in the post-war U.S. economy.

I suspect a significant part of the gains on large real estate projects comes from the creative and forward-looking methods of the real estate developer who must navigate around the grabbing hand of local regulatory officials as well as other developers competing for the favour of consumers and industry leaders in order to both create and capture value. The HGT reminds us of all that is involved and some of what does not get mentioned in the private production and financing of public goods and services.

Notes

1. Even those who are elderly, retired and managing on fixed incomes, curl up in agony at the thought of another reassessment of their home. The seniors also take some comfort in the knowledge that if the town really does make improvements, they will be able to sell their property at an even more favourable price and move to a location farther away from the CBD.

2. It also can be used by any tax-state to rationalize restrictions on human liberty and mobility. As we explain below, the HGT has been applied to the optimal size of a city analysis. If an additional migrant were found to add more to congestion and other costs than he or she adds to productivity, it might prove necessary to prohibit this migrant's move to the city or charge a 'migration fee' to discourage migration. I remark below how the Communist Party in China might draw ideas from the HGT (Section 5).

3. Of course, with the licensing and permitting processes required by local towns and city governments, the chances of 'insiders' obtaining information about future economic development and obtaining options on the best locations may make the real estate entrepreneur's gains much smaller. That is, he or she may only be able to obtain the needed property rights at 'non-economic prices' as a result of the transparencies of the political licensing processes. The savvy real estate developer must take all this into consideration when planning the project in the first place.

4. On the Corruption Perceptions Index for 2003, China was ranked in 66th place which is about half-way down the list from least corrupt to most corrupt (see Lambsdorff 2004: 285). I suspect that one very obvious form of corruption is associated with the taking away of the land from the farmers with minimal compensation so real estate venturers can benefit. The arbitrariness of many of these incidents is the other side of a lack of a competitive real estate market in China.

References

Andelson, Robert (ed.) (2000). *Land Value Taxation Around the World*, Malden, MA: Blackwell Publishers.

Arnott, Richard (2004). 'Does the Henry George Theorem Provide a Practical Guide to Optimal City Size?' *American Journal of Economics and Sociology*, 63: 1057–1090.

Arnott, R., K. Arrow, A. Atkinson, and J. Dreze (eds.) (1977). *Public Economics: Selected Papers*, Cambridge, U.K.: Cambridge University Press.

Asheim, Bjorn T. (2000). 'Industrial Districts: The Contribution of Marshall and Beyond', In *The Oxford Handbook of Economic Geography*, eds. Gordon L. Clark, Maryann P. Feldman, and Meric S. Gertler. Oxford: Oxford University, 413–431.

Bairoch, Paul (1988) [1985]. *Cities and Economic Development: From the Dawn of History to the Present*, Chicago: University of Chicago Press.

Barker, Charles Albro (1991) [1955]. *Henry George*, New York: Robert Schalkenbach Foundation.

Fisher, Irving (2003) [1906]. *The Nature of Capital and Income*, San Diego, California: Simon Publications.

Foldvary, Fred (1994). *Public Goods and Private Communities: The Market Provision of Social Services*, Aldershot, U.K. and Brookfield, U.S.A.: Edward Elgar.

Fuchs, Victor R. (2005). 'Health, Government, and Irving Fisher,' In *Celebrating Irving Fisher: The Legacy of a Great Economist*, eds. R. W. Dimand and J. Geanakoplos. Malden, MA: Blackwell Publishers, 443–462.

Fujita, Masahisa and Jacques-Francois Thisse (2002). *Economics of Agglomeration: Cities, Industrial Location, and Regional Growth*, Cambridge, U.K.: Cambridge University Press.

George, Henry (1882) [1879]. *Progress and Poverty*, New York: Appleton and Company.

Hanson, Gordon H. (2000). In *The Oxford Handbook of Economic Geography*, eds. G. L. Clark, M. P. Feldman, and M. S. Gentler. Oxford: Oxford University Press, 477–493.

Henderson, J. Vernon (1988). *Urban Development: Theory, Fact, and Illusion*, New York: Oxford University Press.

Hicks, Tyler G. (2000). *How to Make Millions in Real Estate in 3 Years Starting with No Cash*, 3rd edition, New Jersey: Prentice Hall.

Hotelling, Harold (1990) [1938]. 'The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates' in A. C. Darnell (ed.), *The Collected Economics Articles of Harold Hotelling*, New York: Springer-Verlag, 141–165.

Krugman, Paul (2000). 'Where in the World is the "New Economic Geography"?' In *The Oxford Handbook of Economic Geography*, eds. Gordon L. Clark, Maryann P. Feldman, and Merit S. Gertler. Oxford: Oxford University Press, 49–60.

Lambsdorff, Johann Graf (2004). 'Corruption Perceptions Index 2003.' In *Global Corruption Report 2004 [of] Transparency International*, eds. R. Hodess et al. Serling, Virginia: Pluto Press, 282–287.

MacCallum, Spencer Heath (1970). *The Art of Community*, Menlo Park, CA: Institute for Human Studies.

Mills, Edwin S. and Bruce W. Hamilton (1994). *Urban Economics*, 5th edition, New York: Harper Collins.

Mintzberg, Henry (2004). *Managers Not MBAs*, San Francisco, CA: Berrett-Koehler.

Peterson, Ivar (2005). 'There Goes the Old Neighorhood, to Revitalization,' *New York Times*, 30 January, A25.

Putnam, R. (1993). *Making Democracy Work: Civic Traditions in Modern Italy*, Princeton: Princeton University Press.

Roos, Golf De (2005). *Real Estate Riches: How to Become Rich Using Your Banker's Money*, New York: John Wiley.

Rothbard, Murray (2004) [1962]. *Man, Economy, and State: A Treatise on Economic Principles*, Auburn, Alabama: Ludwig von Mises Institute.

Schumpeter, Joseph A. (1961) [1911]. *The Theory of Economic Development*, New York: Oxford University Press.

Scott, Allen J. (2005). *On Hollywood: The Place, the Industry*, Princeton, NJ: Princeton University Press.

Tideman, Nicolaus (ed.) (1994). 'The Economics of Efficient Taxes on Land,' in *Land and Taxation*, London: Sbepheard-Walwyn, 103–140.

Tullock, Gordon (1989). *The Economics of Special Privilege and Rent Seeking*, Dordrecht: Kluwer Publishers.

Vickrey, William (1977). 'The City as a Firm.' In *Public Economics*, eds. R. Arnott, K. Arrow, A. Atkinson, and J. Dreze, Cambridge, U.K.: Cambridge University Press, 339–349.

Wenzer, Kenneth C. (ed.) (2003). *Henry George: Collected Journalistic Writings*, 4 vols., Armonk, New York: M. E. Sharpe.