

## The Physiocratic Tradition

The Physiocrats thrived in France during the third quarter of the 18th century and founded what may be considered as the first school of economic thought, in the modern sense of that term. They called themselves 'économistes' and they acted as an organised group of thinkers who intended to influence the economic policy of their government. The name by which the school is known today is derived from a collection of writings by their master, Francois Quesnay, in a book published by Dupont de Nemours in 1767 entitled *Physiocratie, ou constitution naturelle du gouvernement le plus avantageux au genre humain*. The designation Physiocrats (Greek *physis*, nature, *kratein*, to rule) however did not become current until the 19th century and calls attention to the emphasis the school placed on natural laws and the natural order. The importance of the physiocratic school in the context of this work is that they advocated the abolition of taxation and its replacement with a natural source of public revenue. Further, they believed that government should confine its expenditure to a limit determined by the public revenue naturally available and not the complete reverse — the accepted wisdom today — which advocates expected public expenditure to determine the level of taxation.

Every productive process involves the consumption of some wealth in the production of new wealth and, as the Physiocrats recognised, the one ought to be deducted from the other in order to assess the difference. This difference measures the net increase of wealth which, since the time of

the Physiocrats, has been known as the 'net product'. They argued, however, that only agricultural production had this unique power of yielding a 'net product'. Only when engaged in agriculture did a labourer reap more than he and his industry consumed throughout the year. Consequently commerce and manufacturing were classed as 'sterile'. Sterile did not signify that these occupations were useless but only that they were unproductive in the sense that no extra wealth was produced. They contributed nothing to the 'net product' as the wealth they consumed equalled the new wealth they produced. A great gap in the Physiocratic theory was that they had no concept of value added. Indeed value was rarely mentioned in their writings. Loaves of bread when exchanged for a ploughshare were considered to be of equal value. The largest part, if not the whole, of the 'net product' produced by agriculture accrued, it was argued, to the landed proprietors in the form of rent. On this conclusion regarding the circulation of wealth, which was compared in importance to the discovery of the circulation of blood in the history of biology, rests the Physiocrats' proposals for the 'Impôt Unique' or single tax.

Public revenue and the theory of taxation forms a large part of the Physiocratic system and is one of the most characteristic portions of their work. Today it is common to ascribe social problems to an unequal distribution of wealth, but the Physiocrats rightly emphasised the true source of injustice to be the burden of taxation. General taxation, they argued, was a deviation from the 'natural order' which must result also in a contraction of future output. After the landed proprietors have deducted the 'net product', there is left to agriculture only the wealth necessary to maintain output. Should the cultivators of the soil be burdened in addition with taxation then there will be that much less capital for the land and this must result in a smaller gross product the following year. They concluded that it is the landed proprietors who, one way or another, will eventually pay the

tax. Since commerce and industry produces no more than the wealth they consume, the imposition of a tax burden on them must reduce their consumption and limit their purchases of raw materials. The only escape from a diminished future production would be if the so-called 'sterile classes' were able to raise their prices by the amount of the tax burden. Again, one way or another, the tax would be borne by the landed proprietors. Given their system, the only available source of public revenue is the 'net product' and, to conform with the 'natural order', this must be collected from the landed proprietors. The essential distinction between taxation and the Physiocratic 'impôt unique' is that, while taxation is of necessity arbitrary, the 'impôt unique' was regulated by a natural norm which gave the amount of the 'net product'. They calculated that 30 per cent of the 'net product' would be sufficient to cover public expenses and Dupont de Nemours emphasised that, if this proved to be insufficient, 'there is only one natural and reasonable conclusion to be drawn from this, namely, curtail the expenditure'.

Although the Physiocratic system has little in common with, and is not directly applicable to, an advanced industrial trading economy much of their work is of contemporary interest. For example, their argument that taxation inevitably restricts future production or leads to an increase in prices, and that there exists a natural source of public revenue which in turn imposes a natural limit on government expenditure. The first is today a fact of common experience and may be deduced from the theory of Keynes formulated more than a century and a half later. The second probably provides the only sure way of restraining spendthrift modern governments, by imposing upon them the discipline of having to live within their income as do private persons. Also of interest is their demonstration of the special nature of the income from land and their proposal for a single tax. This latter concept was expounded within the

context of an industrial trading economy, apparently without any prior knowledge of the earlier Physiocratic work, in the second half of the 19th century by the American, Henry George. George left behind him a worldwide single tax movement which continues today with centres in most countries and regular international conferences.

## Henry George

Like the physiocrats Henry George stressed the natural order of things and was in addition, it is interesting to note, more concerned with the quality of life and the environment than most of the late 20th century 'Greens'. The idea that the environment is a common heritage for future generations was fundamental to his work. He is best known today for *Progress and Poverty*, first published in San Francisco in 1879. It remains an all-time best seller on the subject and was subtitled 'An enquiry into the cause of industrial depressions and of increase of want with increase of wealth . . . the remedy'. For George the remedy was simple and practical: 'abolish all taxation save that upon land values'.<sup>1</sup> Like all great works of political economy it was directed at a public issue of topical importance at the time of writing. An earlier example of this was Ricardo's formulation of the theory of rent which provided the theoretical support for his argument that the high price of corn was not caused by the high price of cornland, but on the contrary, that the then high price of cornland resulted from the high price of corn.<sup>2</sup> For Ricardo corn was a synonym for wheat and the prevailing high price of wheat was an important public issue in the United Kingdom at the beginning of the 19th century.

Similarly in the 20th century Keynes was writing for his time when he argued in his *General Theory* that supply could not be relied upon always to create its own demand.<sup>3</sup> During the inter-war years of the depression the continuing deficiency of aggregate effective demand was a public issue of

international importance. Henry George was concerned to demonstrate that the growth of population, especially the growth of densely populated cities, is not of necessity associated with ever increasing poverty: an important public issue in his time which remains very much with us today. The pessimism of the then authoritative arguments based on the assumption of the niggardliness of nature was not for George. 'It is a well provisioned ship', he wrote, 'this on which we sail through space'.<sup>4</sup>

Although a contemporary of Alfred Marshall, Henry George remained a Ricardian. He considered that, for example, 'as to the law of rent there is no necessity for discussion'.<sup>5</sup> This did not prevent George from recognising that Ricardo's theory of rent failed to explain fully the rapid growth in the rent, or price, of land in a developing trading economy such as the United States in the late 19th century. He accepted the then orthodox view that the cause of the rapid rise in rent was increasing population, but concluded that Ricardo's explanation, the lowering of the margin of cultivation, was of minor importance. Of major importance, he concluded, was that increasing population brought out in land special capabilities otherwise latent, and attached special capabilities to particular lands.<sup>6</sup> The exposition by which he arrived at this non-Ricardian conclusion can shed much light on contemporary issues of public finance. George begins by supposing a first immigrant arriving in an unbounded savannah every part of which is equally fertile.<sup>7</sup> This supposition is of importance for George's argument for it precludes any possibility of rent arising in accordance with Ricardo's theory. An increasing population cannot be the cause of lowering the margin of cultivation in an unbounded savannah every part of which is of equal fertility. The first immigrant would settle, George supposed, somewhere by chance, but the subsequent immigrants would be attracted to the lands as near as possible to the first settlement. He observes with St Thomas Aquinas<sup>8</sup> that man is gregarious by

nature, but carries the observation further. Not only would they do this in the expectation of enjoying a better quality of life from social intercourse, but also in the expectation of enjoying material gains as a result of one settler co-operating with his neighbours on particular tasks. As the new settlement grew, George noted, there would very soon arrive a specialist blacksmith, a wheelwright, a store, and so on. For reasons of business these specialists would be attracted to central locations. Every settler would gain an advantage from having these services provided locally, but the first immigrant, being handily located at the centre already, would gain more than those later immigrants located at the periphery, which by this time might be relatively far off. As George put it, land at the centre of the settlement 'begins to develop a productiveness of a higher kind'.<sup>9</sup> Thus the value of the first immigrant's land will begin to increase relative to that of later immigrants, not from any lowering of the margin, but from the margin of production being raised. This increase in value George called 'rent'. As the population grows the process continues and the settlement becomes a village, the village a town and perhaps eventually a great city. The farmers, argued George, may move on but the specialists must remain at the centre of exchanges to be viable. Eventually the land of the first immigrant, now being located at the centre of a thriving community, becomes so valuable as to enable him to lease or sell his land and retire as a very rich man. As rents and the price of land increase so the proportion of the wealth produced going to capital and labour diminishes — hence George's title, *Progress and Poverty*.

Mindful of the important social and political issues of his day, Henry George emphasises in his savannah story the association of increases in population with the growth of the income he called rent and the consequent extremes of wealth and poverty. But an association, however well proven, does not imply causation in either direction. The demonstration that it is only after the population has grown to a certain size

that the price of land is greatly enhanced, is not sufficient grounds for concluding that the population growth is the cause of the enhanced price or is dependent solely upon this growth.

Today George's story is instructive more for what he failed to observe than for what he actually observed. For example, the story begins with a settlement of neighbourly self-sufficient farming households co-operating one with another, but trading only what happened to be surplus to their household requirements. With the arrival of the blacksmith and other specialists a fundamental change takes place. A settlement of self-sufficient farming households is changed into a *trading* economy. The various individual enterprises no longer produce an output primarily for their own subsistence but in part, and in certain cases wholly, for the purposes of trade. George takes no account of this fundamental change. Again, George, like Ricardo, fails to observe the necessity of an *effective demand*. What causes the blacksmith and other specialists to set up in the new settlement is not the population size, but the existence of an effective demand for their services and products at least sufficient to yield them a living. Size and density of population may be a rough indicator of the existence of an effective demand for certain services, but the one is not of necessity positively linked to the other. More important is that, even given the initial effective demand, an embryonic trading community will not grow automatically into a town or a great city as George supposed. If trade and industry are to flourish within a community, then certain expenses must be incurred to provide the *public services* required by those living and working at particular locations. The development of the 'higher kind of productiveness', as Henry George called the manifestation of locational advantages, will not persist if Main Street is allowed to remain a lawless quagmire and the whole area bereft of all public services. Indeed, in such conditions, the locational advantages of operating at the

centre or any other part of the community might disappear completely, with trade and industry departing for other centres where public expense is incurred for the provision of necessary public services. The population would follow jobs. George failed to note that the rise in the price of land at those sites enjoying locational advantages is in fact a measure of the effective demand for public services. Although he recognised that in the circumstances he supposed, the rise in the price of land had nothing to do with the productiveness of the soil, the dictates of Ricardian economics obscured from him the actual cause and led him to conclude the rise to be a different mode of Ricardian rent manifested when increasing population brought out other natural gifts otherwise latent in the land.

1. Henry George, *Progress and Poverty*, Bk.VIII Ch.II.
2. David Ricardo, *The Principles of Political Economy and Taxation*, Ch.II.
3. J.M. Keynes, *The General Theory of Employment, Interest and Money*, Ch.II.
4. Henry George, *Progress and Poverty*, Bk. IV Ch. II.
5. *Ibid.* Bk.III, Ch.II.
6. *Ibid.* Bk.IV Ch.II.
7. *Ibid.* Bk.IV Ch.II.
8. Thomas Aquinas, *On Princely Government*, Bk.I, Ch.II.
9. Henry George, *op. cit.* Bk.IV, Ch.II.