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Public Revenue

As argued explicitly by the Physiocrats and Henry George, and as may be deduced from the works of Alfred Marshall and others, the price of land is the key for collecting public revenue as an alternative to an arbitary levy such as taxation. What appears to be the market price of land is in fact a measure of the market price of those goods and services which Barone defined as being 'not susceptable to individual and specific demand and divisible supply'.[1] In common usage it is usual to refer to owners of land, or landowners, but the Law of England, for example, provides more precise terminology. What is owned is not the land as such but freehold property rights over land. Those persons who are commonly referred to as landowners are in practice freeholders, for what they own are the freehold property rights over land. The current market price of these rights over land is the sum of two distinct parts which may be called, following Marshall's argument, their private value and their public value. Marshall's definition of private value proved to be too wide and this led him into difficulties when, in his next chapter, he came to define 'situation value'. Given vacant possession, the private value of a freehold is that part of its market price a willing buyer will pay a willing seller for all the improvements resulting from the work and outlay *directly* on that land by the succession of freeholders and/or occupiers of that land. These improvements are properly called private value as first, in the nature of things, they ultimately fall into the possession of the freeholder for the time being. Second, the enjoyment of this property right by the freeholder conforms to the principle of private property (p.12). By definition, either the private value has been produced by the present freeholder's work and outlay, or, in the absence of evidence to the contrary, it is to be presumed the freeholder has received it by way of gift or fair exchange from those who did produce it. Any income yielded by private value, either in cash or kind, is a private income. It is a private income since it is the return on the freeholder's investment of work and outlay directly on the land over which freehold property rights are enjoyed. Where the investment has been made by an occupier who is not the freeholder then, depending on the terms of the tenancy agreement, the return may be the private income of that occupier until such times as a new bargain is struck.

The presumption of title to private value in favour of the freeholder may be objected to on the grounds, as Mill argued,[2] that the ownership of land does not of itself conform to the principle of private property. The substance of his argument is that no person can show they produced land itself or provide evidence that they received it by way of gift or fair exchange from whoever did produce it. Even if the validity of this argument is accepted, the objection does not hold in the present context. The private value of freeholds is produced over the years by the work and outlay of private persons or corporate bodies; titles pass in good faith from seller to buyer through to the freeholder who for the time being enjoys possession. The fact that in times long past freehold titles may have been obtained by conquest or fraud is immaterial. While the acquisition may have been wrong, the revival of a claim long dormant will cause a further wrong and for this reason most countries impose a legal time limitation. On these grounds it is equitable to presume that in the absence of recent evidence to the contrary, the present freeholder has title to the private value attached to the land over which the freehold property rights are enjoyed. The same presumption applies to any income that may be generated by private value. In conformity with the principle of private property a government has no right to impose a tax on the private value of a freehold or otherwise appropriate any part of it by force or fraud. Indeed a government has a duty to uphold and secure to private persons and corporations the full enjoyment of the private value of their freeholds. This duty applies with equal force to any income generated by the private value of a freehold for this is a private income. To enforce the payment of a tax on private value or private income as if it were a debt is to obscure the nature of the original wrong.

The public value of freehold property rights over land is that part of its current market price a willing buyer is prepared to pay a willing seller for the net *external* economies, advantages and other benefits an occupier expects to gain from the occupation and use of that land. Thus, this definition of public value is precisely what Marshall called 'situation value' and follows by contrast from the insertion of the term 'directly' when defining private value above. Alternatively, public value is the market price of a freehold less its private value. It is the actions of the community as a whole and, in particular, the provision of public goods and services by public authorities that produces the public value of a freehold. In a developing country an embryonic trading centre may grow to become an important city where, as Henry George argued and experience confirms, property rights over land change hands for astronomical sums of money. This will happen only providing the necessary public expenditure is incurred on such things as metalled roads, sewerage, drainage, water supplies, street lighting, law and order and so on. Should this necessary public expenditure not be forthcoming then the embryonic trading centre will atrophy by reasons of mud, disease and lawlessness. The high prices paid today for sites in major cities reflect their high public value produced largely at public expense. An example of how this manifests was featured in *The Times* (October 7th 1986). The article listed Aylesbury Grammar School, a free state school, among the top twenty boys' schools in England and noted 'House prices in the area pushed up as a result of parents moving into orbit'. The enhanced house prices are in fact a measure of the increased public value produced by this quality state grammar school within its catchment area. There is a specific demand for good education and in the market place most parents who can afford to do so are prepared to pay the price. Today some of these parents pay the price as fees to independent schools, while others pay for good 'free' state education through enhanced house prices. In cases like these, law and fiscal policy allows the increased public value to accrue to the seller of the freehold as if it were a private value.

The British government has announced that the capital and environmental costs of constructing the high speed rail link between the Channel Tunnel and the North is to be passed on to the users of that rail link. The rail link is forecast also to raise property prices significantly throughout its catchment area. By treating public value as if it were private value, the government will force users of the rail link, through higher charges, to make a free gift of windfall profits to the fortunate existing freeholders. This policy must result in higher charges and a lower demand for the service to the detriment of the community as a whole.

Both the private value and the public value of a freehold are produced over time by the work and outlay of people and, like all products, may be destroyed. Thus as neither value is 'original and indestructable' they cannot give rise to a rent in the strict Ricardian sense of that term. However, both values may give rise to a rent in the modern economic sense of a surplus over and above transfer earnings of a factor of production which is, during a given time period, in fixed supply. Both the improvements which give rise to private value and the externalities which give rise to public value take time to produce and during this time they may be considered as in fixed supply. Those enjoying already existing improvements and those occupying locations benefitting from already existing externalities during the limited production period may receive a rent in the sense of an income in excess of the transfer earnings of the particular factor in fixed supply. Again, both the private value and the public value of a freehold may give rise to a rent in the common usage of that term as a hire charge. For example, a regular payment (hire charge) for the flow of benefits and advantages expected to be received, including the additional income expected to be earned from the occupation of a particular site having a certain public value, may be called a rent. However, in economics the usage of the term rent in the context of the private and public value of freehold property rights over land is likely to be confusing if not misleading. Alfred Marshall is one example of being led into error by the Ricardian associations of the term rent. As has been argued, the income generated by private value is a private income, the regular payment a willing buyer may be expected to pay a willing seller for enjoying, through the occupation of a particular site, the various economic externalities reckoned as public value is rightly a *public revenue*. This description conforms to the principle of private property. Public value is produced by the public in general and by their public authorities in particular and so the income generated by these actions is a public revenue. Government has a *duty* to the public to collect this revenue on their behalf.

The Question of Land

No amount of work or outlay will produce land and, therefore, land of itself cannot have a private or a public value. Both these values are produced by the actions of people. Land falls into that category Marshall calls 'free gifts of nature' and, providing government performs its public duty by collecting public revenue, *land is a free good.* It may be argued that in the case of reclamation schemes land is produced, but this argument ignores the fact that the land was already there. The work and outlay put into reclamation schemes does no more than transform land covered by seawater into dry land. Depending on circumstances, the freehold property rights over this dry land may have a private value, a public value, or a combination of both. Again, the sun, sand and beauty of Spain's Mediterranean coast has existed for thousands of years, yet for most of that time the region was impoverished and property rights over land worth little or nothing. The relatively high prices of these property rights today is not nature's free gift to the owners of those rights, but a gift from those whose work and outlay has contributed to the prosperity of Northern Europe, to advances in transportation, to the building of roads, airports and the provision of all kinds of public services. It is all this work and outlay that has produced both the public value and the effective demand by giving to many thousands of people the opportunity of enjoying a Mediterranean holiday. The increase in public value makes it profitable to increase private values and it is these two combined that has greatly enhanced the prices of property in most parts of the region.

Land is different from natural resources. Although there are similarities, the differences between the two are of importance. Both land and natural resources are produced, so far as their physical composition is concerned, by nature without human effort and remain in their natural place in the universe, but there the similarity ends. To be classified as a natural resource the location of that resource must be known and, although it may remain for the present unused in its natural place in the universe as a reserve, there must exist, or be expected to exist, an effective demand. For example, there does exist today an effective demand for oil and thus known oil reserves are natural resources. In former times crude oil oozing to the surface resulted in what in the United States were called 'bad lands'. There was no effective demand for the crude oil and its presence on the surface rendered the land useless for agriculture. The inventions of more recent times have created an effective demand for crude oil and these former 'bad lands' gave access to an oil-field. Property rights over 'bad lands' became so valuable that the owners found themselves to be millionaires without any work or outlay on their part. Again, a distinction is required between natural resources and raw materials. For example, coal reserves lying unused in their natural place in the universe are a natural resource, but to a miner working at the coal face they are his raw material.

From Alfred Marshall's argument in respect of barren heath land,[3] it is to be concluded that natural resources give rise to a public value and, therefore, providing government perform their duty of collecting the public revenue, the necessary work of exploration is a matter for government initiative. This does not imply the need to expand the public sector by setting up vast state corporations, for in most cases there are likely to be advantages in government employing private specialist firms on the basis of competitive tendering. The United Kingdom has moved already some way towards the recognition of natural resources as public assets to be excluded from private property rights over land. It is not now possible for a freeholder in the U.K. to become an oil millionaire by fortunate accident, as freehold property rights do not extend to any oil that may found below the surface. The private sector firms that engage in oil exploration operate today under government licence. The important difference between land and natural resources is that human work and outlay cannot produce land, while natural resources are the product of the human work and outlay put into enterprises that lead to their discovery so as to meet an effective demand.

The Public Sector

Enrico Barone (p.83) and most other writers on public finance assume the extent of the public sector to be determined by political rather than economic considerations. Orthodox economic theory reinforces this assumption by 'the very bareness of the economic principles'[4] it is able to provide. In practice governments decide on what is to be included or excluded from the public sector on a majority vote based largely on political expediency or ideology. The possibility of Alfred Marshall contributing to the issue was lost in a welter of exceptions to his definition of 'situation value' that followed inevitably from his definition of 'private value'.[5] For example, as mentioned earlier, while admitting that the larger part of 'situation value' is 'public value', he was forced to argue that, when the owners of freeholds invest their capital not directly on their freehold but in building a railway or some similar enterprise which gives to their freehold a 'situation value', then that value is a 'private value'. The income generated is to be considered, he concludes, as a private profit on their investment. This line of argument does not elucidate any economic principle but merely accords with current practice. However, when the private value of freehold rights over land are defined as above, so that public value is precisely Marshall's 'situation value', there emerges the possibility of determining the extent of the public sector by economic principle rather than political considerations.

Let it be supposed that government performs its public duty and collects the total public revenue for the purpose of defraying public expenses and there is no taxation. Given this circumstance, then the exceptional cases noted by Marshall where 'private value' is part of 'situation value' will not arise. Freeholders will be encouraged to invest directly on improvements to their freeholds to the extent that this is expected to yield a private income or benefit they consider to be an acceptable return on their investment. Such investment will enhance the private value of their freehold and may also enhance public values. For example, when two or three properties in a run-down street are improved then not only will the private value of those particular properties be increased, but the investment is likely to have an incidental effect of raising the public value of all properties in the street. However, apart from acts of philanthropy, freeholders and others will not be prepared to invest in enterprises that are expected to enhance the public values of freeholds rather than their private values. In such cases investors will know in advance that they cannot expect a sufficient return on their investment to make the enterprise a commercially viable proposition. The government will be collecting as public revenue that part of the income generated by 'situation value', which Marshall argued should be considered as private profit, so as to provide a sufficient return on capital outlay. In the supposed circumstance Marshall's exceptional cases illustrate an economic principle for determining the parameters of the public sector. Acting on this principle then, the public sector would cease to consist of whatever a legistlature by a majority vote may in its wisdom decide, as Barone accepted and contemporary governments act upon as if it were a self-evident truth.

Providing governments collect the whole of public revenue and do not appropriate by taxation or similar means any part of private income, then they may safely leave to market forces and private sector initiative all enterprises where the work and outlay is expected to yield a private value or income sufficient to cover the total supply price including a minimum margin of profit. The public sector may then be limited to the supply of those goods and services for which there is an effective demand by the community as a whole, but where also the work and outlay is not expected to yield a private value or income sufficient to provide an acceptable return to private investors. If such an effective demand is to be met then, as Barone argued, public initiative using public funds is necessary. When government act in accordance with this economic principle their decision making is assisted by a kind of built-in cost-benefit analysis which determines whether there exists in reality an effective demand and its extent. When the demand by the community as a whole for government to supply certain goods, services or benefits out of public funds is effective, then the meeting of this demand will increase public value and the expected revenue to a level that will cover the full supply price, or that part of it which it would be self-defeating to attempt to cover by receipts from market prices in the ordinary way. In those cases where it is agreed the public value and expected public revenue would not be increased to cover the expected supply price, then there does not exist within the community an effective demand sufficient to necessitate a government initiative. Thus, with taxation abolished and given prudent government, public revenue will be, by definition, sufficient to cover all necessary public expenses. There will be room in addition for limited public initiatives using public funds to meet demands on political grounds, although they may not be expected to be effective demands relative to any likely increase in public value or revenue.

As noted above some public value and revenue is produced by the general public automatically in pursuit of their private ends at no public expense. Further, it is reliance on taxation as a source of public revenue to defray public expenses that has allowed government to escape from financial restraints and establish, as an accepted principle of public finance, that they adjust their spending estimates to the available public revenue. When government perform their public duty of collecting the public revenue and act in accordance with economic principle they become subject to the same financial discipline as applies to the private sector. Under these conditions, taking one year with another, government is required to adjust its spending to expected public revenue and this provides the much needed barrier to public profligacy.

1. Enrico Barone, *Giornale degli Economisti*, April/May 1912.
2. John Stuart Mill, *Principles of Political Economy*, Bk.II, Ch.II.
3. Alfred Marshall, *Principles of Economics*, Bk.V, Ch.X, para 5.
4. A.R. Prest, *Public Finance*, page 65.
5. Alfred Marshall, *Principles of Economics*, Bk.V, Ch.XI.