

The Economics of Henry George: A Review Essay

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ABSTRACT. This is a welcome addition to the literature on Henry George. Bryson seeks to “rehabilitate” George—by highlighting his major achievements, by explaining why academic economists have rejected or neglected him, and by showing how nonetheless George has had a major but little-acknowledged impact on economic thought.

Phillip Bryson, Professor Emeritus of Economics at Brigham Young University, has published a number of books on economic history. A few years ago, he came across a copy of Henry George's *Progress and Poverty* (1879) in his mother's library. Intrigued, he pursued the story of George's astounding international career and subsequent apparent eclipse. The result is this short book, admiring but not uncritical—and mercifully free of the snide tone that has characterized much scholarship on George for the last hundred years—see Heilbroner (1986) and Blaug (1985).

Bryson seeks to “rehabilitate” George—by highlighting his major achievements, by explaining why academic economists have rejected or neglected him, and by showing how nonetheless George has had a major but little-acknowledged impact on economic thought. He divides his book into six sections: George's methodology; George's life and religious views; George on distribution; George on free trade; George on land policy; and George's

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influence on modern economics. I will start with distribution, George's most important contribution.

Henry George's Theory of Distribution

Henry George (1839–1897) first laid out his theory of distribution in *Progress and Poverty: An Inquiry into the Cause of Industrial Depressions and of Increase of Want with Increase of Wealth . . . the Remedy* (George [1879] 1962). The book quickly became a worldwide best-seller. Bryson contrasts George's theory with that of the great British economist Alfred Marshall (1842–1924) in his *Principles of Economics* (Marshall 1920), as well as of George's American contemporary, Francis Amasa Walker (1840–1897). He writes that “George may have contributed the best classical analysis in history, but it was Marshall who constructed the bridge from the classical to the contemporary world of economics” (Bryson 2011: 47).

Classical economic theory identifies three factors of production: land, consisting of all natural resources; labor, consisting of productive human effort; and capital, variously defined. The classical theory of distribution identifies social classes with income distribution. Landlords receive rent, determined, as David Ricardo proposes, by the difference between a given class of land and marginal land (Ricardo [1818] 1996). Labor receives wages. Capitalists receive interest on the funds they advance.

George follows Ricardo in claiming that population growth pushes the margin onto increasingly inferior land, channeling more and more rent to landlords, leaving less and less for interest and wages. But he adds his own unique twist, derived from observation at the frontier of American settlement: large landholders—“land monopolists”—hold good land out of use. Some, especially in a rapidly growing economy, may be actively “speculating”: buying in anticipation of large price increases. Others, notably wealthy absentees or railroads, have acquired land they cannot manage, but feel no pressure to sell. Large landholders engage in such behavior without necessarily colluding. Consequently, as George puts it, “the speculative advance in land values tends to press the margin of cultivation, or production, beyond its normal limit, thus compelling

labor and capital to accept of a smaller return, or (and this is the only way they can resist the tendency) to cease production" (George [1879] 1962: 264).

George attacks the prevailing, somewhat incoherent classical theory of the wages fund: the idea that wages depend on the ratio between the funds advanced by capitalists and the number of workers. He also attacks the Malthusian hypothesis that seems to bolster the wages fund—the idea that the working class breeds itself into poverty. Instead, George proposes that "*Wages depend upon the margin of production, or upon the produce which labor can obtain at the highest point of natural productiveness open to it without the payment of rent*" (George [1879] 1962: 213).¹ In modern language, wages are determined by marginal product of labor at the extensive margin. George recognizes that, by arbitrage, wages at the extensive margin simultaneously determine wages at the intensive margin, that is, wages everywhere. In this way, George originates the marginal productivity theory of wage determination, consistent with Ricardo's theory of rent determination, and a key step toward neoclassical marginal analysis.

George combines his marginal productivity theory with his observations on land withholding by large landholders to produce a modified and internally consistent classical theory of distribution with a novel twist: the greater the inequality in land ownership, the lower the wages and interest.

There are glitches in George's model: contra the classical economists, he insists that capital is not a separate third factor of production, but an adjunct to labor—and that therefore wages and interest rise and fall together. He does not allow capital to displace labor. And, consistent with his shaky concept of capital, he insists that wages are paid from the output of labor—which would be true only for instantaneous production, not for production taking any length of time.

By contrast with George, Marshall ignores the wages fund theory, save for a brief appendix (Marshall 1920: 822–829). He lays out a generalized theory of marginal production, of which labor is just an instance: "Every agent of production, land, machinery, skilled labour, unskilled labour, etc., tends to be applied in production as far as it

profitably can be" (Marshall 1920: 521). "[T]he wages of every class of labour tend to be equal to the net product due to the additional labour of the marginal labourer of that class" (Marshall 1920: 518). However, Marshall carefully adds that "[t]he doctrine that the earnings of a worker tend to be equal to the net product of his work, has by itself no real meaning; since in order to estimate net product, we have to take for granted all the expenses of production of the commodity on which he works, other than his own wages" (Marshall 1920: 518).

Marshall observes that French and English economists "represented value as governed almost wholly by the cost of production, demand taking a subordinate place" (Marshall 1920: 505)—as if in a stationary state. He proposes the modern system, in which prices, quantities, and factor shares are determined by the aggregate of supply and demand in individual markets. The classical economists, including George, ignore individual markets and look only to the gross shares of national income.

George sees land and rent as special. Land is fixed in supply, and has no cost of production. To its owners it yields rent, an unearned income. By contrast, Marshall seeks to treat all three factors of production symmetrically. Thus land, like capital and labor, has an opportunity cost—its value in the next most productive use. By this logic, all productive factors may earn short-term "rents"—the difference between their actual earnings and earnings in the highest alternative use. But competition will eventually extinguish these rents.

Bryson observes that today neoclassical theory appears flawed in two respects. First, as famously noted by Blaug, "marginal productivity seems to have a limited content and narrow conclusions as compared with classical theory" (Blaug 1985: 437) (Bryson 2011: 65). Second, there is the aggregation problem. Productivity theory works nicely at the local level, but once we start to aggregate, the results become indeterminate—a glaring problem with modern macroeconomics. This flaw periodically generates academic catfights, notably the famous Cambridge controversy of the 1950s–1970s.

Bryson concludes that "[t]here is no agreement in economics that the neoclassical theory of distribution ensures the ultimate and final

state of our understanding of both the contribution and the rewards of the productive factors. These achievements are certainly clever and intellectually satisfying, but it is not apparent that they are vastly superior to the kinds of changes that George was offering for the classical model . . ." (Bryson 2011: 64).

George's policy remedy is the "single tax" on land values, replacing all other taxes. By draining economic rent from speculators and other idle landholders, it would force them to make withheld land available. After coming up with the idea on his own, George was pleased to find he had been anticipated by the French Physiocrats as well as Adam Smith, David Ricardo, and John Stuart Mill. Despite some public disagreements with George, Marshall actually supported a land tax proposal when it was advanced by British Prime Minister David Lloyd George as part of the People's Budget in 1909.

Back in the USA, Henry George bested Francis Walker in a debate on farmland concentration in the semi-popular press (Gaffney 1994: 67). As President of MIT, Walker never relented from denouncing George, contributing to the scorn in which most academic economists have held George ever since.

Meanwhile at Columbia University, John Bates Clark (1847–1938), a dedicated opponent of George, also picked up marginal productivity theory from George (Bryson 2011: 142); also see (Stabile 1995)—and turned it against George. Instead of recognizing how distribution affects marginal product, Clark's static analysis implicitly takes distribution as given. Contra Marshall (see above) Clark writes, "the share of wealth that falls to any producing agent tends, under natural law, to equal the amount that he creates. A man's pay tends to equal the value of the product or fraction of a product that can be specifically imputed to him" (Clark 1898: 4). "Natural law" indeed! Clark compounds the distortion by merging land with capital, because "land and artificial goods are blended in an intimate mixture" (Clark 1908: 190)—rendering George's analysis and remedy meaningless (Gaffney 1994: 56). Neoclassical economics in the USA followed Clark, to the extent that Robert Solow could joke in 1955 that "... if God had meant there to be more than two factors of production, He would have made it easier for us to draw three dimensional diagrams" (Solow 1955: 101).

Henry George on Free Trade and Protection

In 1886 George published *Protection or Free Trade: An Examination of the Tariff Question, with Especial Regard to the Interests of Labor* (George [1886] 1992). At a time of major controversy over US tariff policy, the book extends the classic free trade case of Adam Smith and David Ricardo. The book is a polemic; its most-quoted passage holds that protection does to a nation in times of peace “what enemies seek to do to us in time of war” (George [1886] 1992: 47). George treats tariffs the same as he treats taxes in *Progress and Poverty*: a burden on capital and labor, and a drag on productivity. He adds a moral dimension. Humans are “made for cooperation”; trade is a natural form of cooperation, leading to peace and prosperity “Without trade, man would be a savage” (George [1886] 1992: 51).

Bryson notes that George adds some quite sophisticated reasoning. For example, George argues that taxes or tariffs on widely-used commodities will fall harder on the poor than on wealthy buyers, increasing inequality. Moreover, Bryson writes, “When I went back to review Henry George’s work on trade, I was surprised at the number of issues he addressed that I thought had not appeared on the scene until later or much later. These are issues that gave scholars like Heckscher, Ohlin, and Paul Samuelson, and the authors who worked with them, a good deal of scholarly fame along with Nobel Prizes in economics” (Bryson 2011: 102). These issues include so-called fair trade, the “optimal tariff,” and the Stolper-Samuelson argument that specialization will bring higher returns to factors of production used intensively.

George puzzles as to why working men fail to understand the benefits of free trade and stubbornly call for protection. Perhaps it is because they see no gains in pay. And that can only be because ultimately the gains from free trade go to the landholders. Again, the answer is “to abolish private property in land” by collecting the economic rent through taxation (George [1886] 1992: 320)

Henry George on Land and Land Policy

In 1858, George settled in San Francisco, where he became a newspaper writer and editor. As population flooded into California, he

witnessed first-hand its transformation from a place of modest living and rough equality to one of great wealth and poverty. He also encountered monopoly. First there was Western Union—which ruined his paper by denying it access to eastern news. Then there was the Southern Pacific Railroad, to which the US Congress granted vast tracts of land in exchange for building lines—except that the lines often did not get built, and SP's landholdings impeded settlement. Besides SP, a horde of fraudsters grabbed choice chunks of public domain, and failed to put them to use. In 1871 George published his observations in a little book called *Our Land and Land Policy, National and State* (George [1871] 1900). Despite the bland title, it could have been a Sierra Club polemic!

As Bryson observes, it was this dramatic California experience that led George to theorize that large-scale land withholding prevents the working classes from sharing in the benefits of population growth and improved technology. George argues that all men have an inherent and equal right to share the natural abundance of the earth. When land monopolists block access, they make men virtual slaves. George's outrage at this injustice drives much of his writing.

At the same time, like the other classical economists, George looked favorably on competitive markets and regarded government with suspicion, especially after watching the corruption during the land boom frenzy. What policy could remedy the injustice of land monopoly without heavy-handed state intervention? George came up with a simple, practical policy based on the existing property tax system that then supplied most public revenue in the United States. Ideally, the property tax falls as a uniform percentage on the market value of all property within a jurisdiction (except exempt property like churches), land and improvements alike. George said shift the tax to land values only, and eliminate all other taxes. Untaxing improvements would eliminate the burden on investment; more important, raising taxes on land would force the land monopolists to put the land to use, or sell it to those who would. George's remedy soon became known as the "single tax."

The "single tax" attracted a huge and enthusiastic "Georgist" following around the world. Land taxes were partially or fully implemented in parts of the US and Canada, in Australia, New Zealand, and

South Africa, in Denmark and elsewhere. (See *Land Value Taxation Around the World* (Andelson 2000).) As mentioned, in England David Lloyd George's budget of 1909 include a land value tax. George's campaign against monopoly also strongly influenced the Progressive Movement's assault on the "robber barons" in the early 20th century.

Henry George on Economic Methodology

Bryson starts his book with a short chapter on George's methodology. Why methodology?

First, George's academic contemporaries attacked him for relying on classical thinking at a time when marginal methods were becoming fashionable. As Blaug puts it quite unfairly, *Progress and Poverty*, "a wonderful example of old-style classical economics, was thirty years out of date the day it was published", (Blaug 1985: 85). Moreover, between then and his death in 1897, George stuck to his guns.

Second, throughout his work, George emphasizes good methodology. At the outset in *Progress and Poverty*, George criticizes his predecessors for sloppy and inconsistent use of terminology, and failure to apply logical principles to their arguments. He criticizes Adam Smith for failing to define "wealth." He demolishes Thomas Malthus's crude "mathematical" proof of his population thesis. He insists that the laws of rent, wages and interest must be "co-ordinated" that is, consistent. George's devotes his unfinished last book, *The Science of Political Economy* (George [1897] 1981), to a sophisticated discussion of economic methodology. He attacks the new economic thinking, including Marshall's *Principles of Economics* (first edition 1890), on methodological grounds.

Economics is not a linear science like physics. As Bryson puts it, "Economists now seem to agree that one should not expect a theoretician's work to be grounded in methodologies not developed during the lifetime of that economist" (Bryson 2011: 2).

The Life and Economics of Henry George

In the eyes of contemporary academic economists, George was not one of them. Growing up poor in Philadelphia, he left home early to

travel the world on a merchant ship. In San Francisco, he became first a typesetter, and then a newspaperman. He was entirely self-educated. He was also deeply religious. This gave his writing a messianic quality; he believed he had a mission. He attracted hundreds of thousands of devoted followers around the world.

In addition, unsurprisingly, his attacks on privilege and monopoly made serious enemies. His land tax proposal threatened large influential landholders. Mason Gaffney has argued that individuals like oil baron John D. Rockefeller and land and timber baron Ezra Cornell in fact financed departments of economics staffed by opponents of George (Gaffney 1994: 73, 117).

In short, professional jealousy, class contempt, resentment of attacks from George, and threats to wealthy interests—all came together to make George anathema to academic economists. They condemned, twisted, or mocked his message. Eventually, they so diminished him that when history of thought textbooks mention George, if they mention him at all, it is to sneer at a preacher with a panacea.²

Henry George and Modern Economics

Bryson here reports on the current literature on George, both from acknowledged admirers of George, and more neutral parties willing to give credit where credit is due. As he reports, “Karl Marx referred to George’s teaching as ‘Capitalism’s last ditch’” (Bryson 2011: 176). Understandably so, because George sought to make capitalism achieve its promise—not by leveling incomes, but by leveling opportunity. George was skeptical of government; the single tax, he believed, would accomplish more than any bureaucracy. Bryson cites Robert Andelson, who argued that George took only two concepts from the socialist menu: first, all individuals have equal rights to nature’s bounties; and second, the community has the right to take that which it produces, that is, economic rent. (George never did clarify at what level of government—local, state, or federal—the community should operate, or how.) In an appendix to the chapter, Bryson reproduces in full Andelson’s eloquent short monograph, “Henry George and the Reconstruction of Capitalism” (Andelson 1994).

George had, and continues to have, a major influence on urban economics. Gaffney has published extensively on how site value taxation can enable cities to realize their promise of bringing people together in productive cooperation (Gaffney 1998). Swedish Bank Prize-winner William Vickrey touted it as a means to enable marginal cost pricing of roads and utilities, optimizing urban efficiency. The thesis that a well-planned city generates sufficient land values within its boundaries to finance all required services has become known as the Henry George Theorem, and is part of the basic canon of public finance theory (Vickrey 2001; Arnott 1997). Nicholas Tideman has applied the theory of the "winner's curse" to land speculation: those who most overestimate the value of land in a bubble are likely to end up owning it—transferring land into the hands of incompetents, often wealthy absentees (Tideman 2004).

Bryson notes that George's ideas have had particular influence in development economics. Among others, he cites Swedish Bank Prize-winner Joseph Stiglitz to the effect that land taxes would improve efficiency and equity in third world agricultural economies (Stiglitz 2003). Stiglitz insists that taxation ought to follow the "generalized Henry George principle," to "tax natural resource rents at as close to 100 percent as possible" and to tax "activities that generate negative externalities" such as carbon emissions (Stiglitz 2010: 5).

Bryson concludes that "the elegantly simple and simply elegant wisdom of Henry George has left echoes in the halls of contemporary economics . . . The honesty of his exposition remains as an example for those who would wander into the world of policy; his caring for the truth and its demands on economic analysis remain aloft as a banner for the future" (Bryson 2011: 190).

Some Weaknesses

In discussing both trade and land policy, Bryson appears unclear on tax incidence and capitalization. As first worked out by Frank Ramsey, taxes are shifted in proportion to the relative elasticities of supply and demand (Ramsey 1927). Since the supply elasticity of land is zero, a landholder cannot pass on a tax. Likewise, a seller does not automatically pass on a sales tax or tariff; in fact the theory of the optimal tariff

describes how a monopsonist importing country can force a low elasticity exporting country to absorb most of a tariff.

As for tax capitalization, Bryson writes, "It is often pointed out that George's single tax is in principle a good idea, but one which in the contemporary United States could not provide the huge amounts of funding required to run government as its scope increases" (Bryson 2011: 159). Bryson misses what Gaffney calls the ATCOR principle: "All Taxes Come Out of Rent," as well as the EBCOR principle: "Excess Burden Comes Out of Rent" (Gaffney 1998: 188–200). (Excess burden or deadweight loss is the production lost when taxes on capital or labor discourage investment or work.) Taxes on capital and labor reduce the value of land by the capitalized value of the tax plus the deadweight loss. Collecting the same amount of taxes from land will actually increase the land values by the capitalized value of the missing deadweight loss. See also Stiglitz's *Economics of the Public Sector* (1988: 567–568).

Bryson cites William Baumol's recent article, "On Entrepreneurship, Growth and Rent-Seeking: Henry George Updated" (Baumol 2004). Bryson is correct that the term "rent-seeking"—a staple of public choice theory—harks back to George. However, Bryson misses the mark when he describes Baumol's desire to "update" George because his work "deals with land . . . the basic . . . factor input of agriculture, which has shrunk continually since George's day" (Bryson 2011: 186). This is a widely-held misconception. George, like his classic predecessors, uses "land" to denote *all* natural resources. George in fact emphasizes urban land, which has increased in value and importance since his day.

Bryson may have gotten this idea from Baumol's observation that "as a share of national income, the rent of land has fallen to a mere two percent" (Baumol 2004: 9). But Baumol's number comes from the National Income and Product Accounts (NIPA), produced by the Bureau of Economic Analysis (www.bea.gov). The NIPA reports "rent" as the imputed rent payments of homeowners to themselves. Otherwise, the NIPA bury economic rent and interest together under profits, and by design exclude a major form of rent: capital gains, realized and unrealized. Two percent is absurd on the face of it. By the ATCOR principle, US rent must be at least as large as US taxes, which recently

have run around 23 percent of GDP, and were much higher during World War II. Bryson references others, notably Dwyer and Gaffney, who set rent much higher. Dwyer conservatively estimates resource rent in Australia, apart from taxes, at about three-quarters of taxes (Dwyer 2003); given ATCOR, rent could pay all Australian taxes with room to spare. In the US, by manipulating items in the NIPA, the Federal Reserve's National Flow of Funds, and the IRS's Statistics on Income, Michael Hudson estimates US economic rent as high as 40 percent of GDP (Hudson 2010). Gaffney shows how even the conventional sources on which Dwyer and Hudson rely omit substantial rent potential (Gaffney 2009).

Bryson continues on Baumol, "[h]uman capital . . . has replaced land as the economy's most vital productive factor," from which it follows that "if people were required to pay a lump-sum tax on the estimated market value of their human capital holdings . . . that tax would likely be as difficult to shift as a tax on land" (Bryson: 187). This is another common misreading of George and economic rent, one that unfortunately infects most modern economics textbooks: the idea that the best example of economic rent is the high earnings of sports superstars like Kobe Bryant. Since Bryant's earnings do not arise from a government-granted privilege, like a title to drill oil, his earnings are not rent.³ On the other hand, I would argue that the multi-million dollar salaries of CEOs contain a substantial share of rent, arising from control of that special privilege, a corporate charter.

Conclusion

So does Bryson succeed in "rehabilitating" Henry George for the benefit of academic economists? Despite some glitches—Bryson is after all an economic historian, not a theoretician—I think by and large yes. He tells the important parts of the story, justifying naming George "America's Greatest Early Economist." I look forward to hearing more from him.

Notes

1. Where is marginal land? It is all around us: poorly-policed public or private land on which poor individuals scabble a living. For example, in New

York City, the homeless dig in trash barrels to collect cans for the 5¢ deposit. Unlicensed vendors lay out knock-off handbags on blankets on the sidewalks, ready to run at the sight of a cop. Drug dealers sneak through back alleys . . .

2. Since the publication of the Fourth Edition of *Economic Theory in Retrospect*, Blaug has taken a kinder view of George (Blaug 2000).

3. Of course the earnings of sports superstars are enhanced by the limited number of sports franchises, which have exclusive territorial rights in major metropolitan areas. So ultimately, Bryant's earnings may include economic rent—not because of the rarity of his talent, but because of the real estate monopoly of professional sports!

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