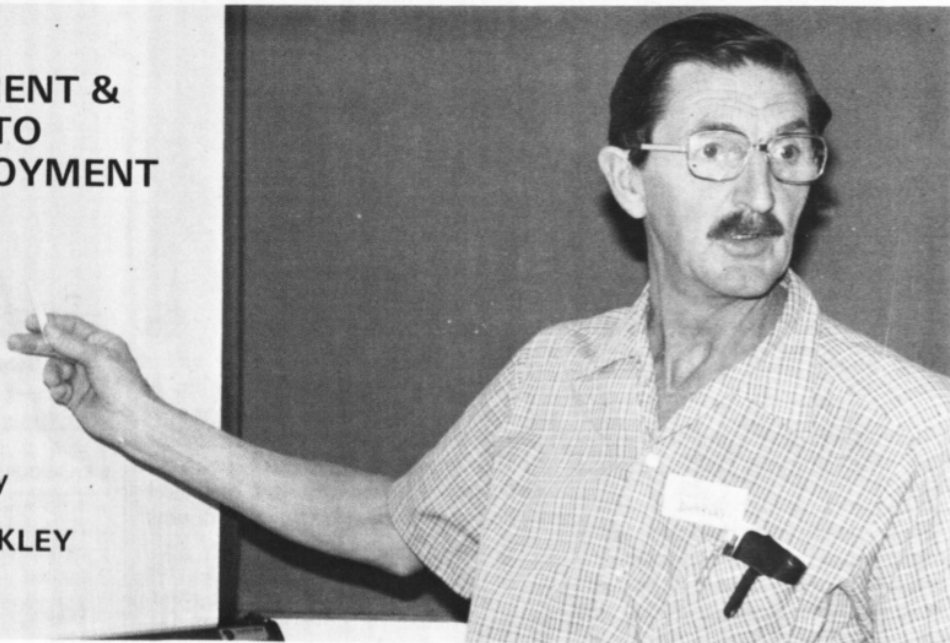


## NATURAL RENT & THE ROAD TO FULL EMPLOYMENT

Analysis by  
**GODFREY DUNKLEY**



● Perplexed statesmen wonder why 35m people will be unemployed in the industrialised countries alone by the mid-1980s. Yet they are in large measure to blame for the global recession!

● In Part I of his analysis, Godfrey Dunkley argues that all taxation is at the expense of economic rent. But because it is largely levied indirectly

– falling in the first instance on labour and its products – economic processes are distorted. And under existing fiscal arrangements, owners are not compelled to release land for use if taxation removes the whole of their rental income.

● Indeed, the present system – while depressing output and robbing the exchequer of revenue – encourages

land speculation. This further reduces the use of land, and increases unemployment.

● In Part II, to appear in the next issue of *Land & Liberty*, the author offers his solution to the macabre situation in which willing hands are denied access to vacant land, thereby consigning people to ever-increasing dole queues.

**M**ANY THEORIES have been put forward recently to explain the origins of the economic disaster in which the West finds itself. Few, if any, of these theories have taken into account the role of taxation.

This may be because of the difficulty many people seem to have appreciating the full significance of taxation as a cause of unemployment, through its impact on marginal land.

In all forms of production, the value added by any enterprise is distributed to labour, capital and land as wages, interest and rent. Wages and interest will be considered as constant in order to better understand the effect of taxation on "economic rent" and production.

Most taxes have the effect of reducing wages to the least that men are prepared to accept, and the tax then comes out of the "natural rent", which is defined below.

*Almost any increase in taxation puts land at the margin out of operation and consequently results in an increase in unemployment.*

### Rent – untapped source of wealth

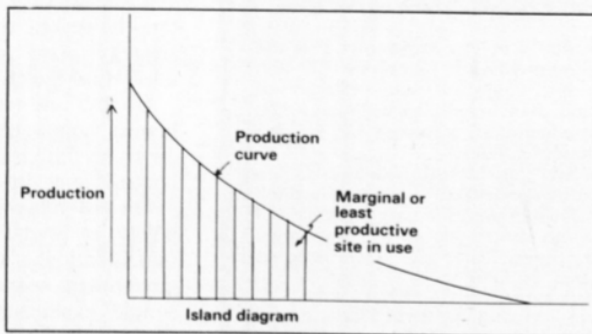
Rent arises from the productive potential of land or by man's desire to hold tenure to that land, irrespective of its potential. The latter condition applies particularly in connection with residential land.

The "Island Diagram" (Fig. 1) will help to introduce the subject. A block diagram or bar chart compares the productive potential of a cross section of typical sites. This ranges from the best or prime sites to the marginal or least productive sites in use under existing conditions. The production blocks are based on the assumption of the

application of equal capital to equal-size land sites.

When a large number of sites are considered in the "Island Diagram" the lines joining the tops of the production bars will be the "Production Curve".

The "General Level of Wages" is governed to a large extent by the production on the marginal sites but reduced by taxation; there is nothing left for rent at the margin. (See Fig. 2.)



● Fig. 1

On other sites, if you subtract wages, interest and taxation from production, the difference is rent.

Ricardo's law of rent states: "The rent of land is determined by the excess of its produce over that which the same application can secure from the least productive land in use."

By implication and practice, the owner of productive land, after paying tax, can appropriate in rent all the return above that required to compensate labour and

capital at the prevailing rate on the least productive land in use. The "Rent Curve" for a number of sites will thus lie somewhere below the production curve.

At this point, we have to introduce a new concept relating to the "Rent Curve". By definition, the rate of wages and interest will be the same on all sites used to establish the production curve. Thus a base line for rent can be established by the line in Fig. 2, which represents the general level of wages and interest. What lies above it is divided between rent and taxation.

Leaving out other factors which have little influence on this reasoning, with the new base line for natural rent, the production curve now becomes the "Natural Rent Curve".

When taxes that fall on individual sites are subtracted from the "Natural Rent" of those sites, the remainder is the "Economic Rent". For this purpose, it is necessary to lump all taxation together; this includes company tax/VAT/PAYE and others. The "Economic Rent Curve" can then be established.

**N**ATURAL and Economic Rent may now be defined in more practical terms.

- Natural Rent is the "highest consistent annual payment obtainable for the use of land, excluding improvements, provided there were no taxes of any kind."

- Economic Rent is the "highest consistent payment obtainable for the use of land, excluding improvements, under the prevailing conditions."

Economic rent is Natural Rent reduced by indirect or direct taxes on production or wages and increased by most forms of grant or subsidy. In practice, Economic Rent is the market estimate of what remains when all costs of labour, interest and taxes have been taken from the productive potential of land only.\*

### What factors affect annual rent?

All forms of rent on land are affected by certain common factors. Rent will decrease with -

- Increasing distance from markets, towns and ports;
- Increasing restrictions on its use;
- Decreasing quality of the soil and climate;
- The presence of undesirable factors, such as obnoxious or polluting industries.

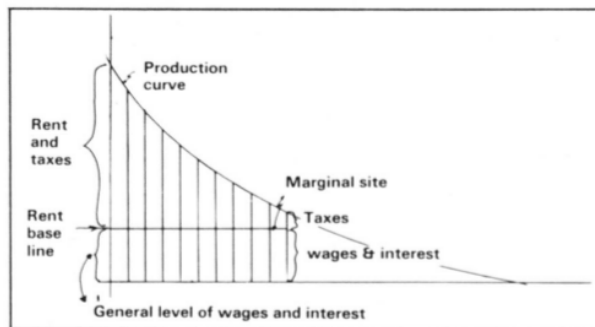
Production is not viable below the margin of production. But this concept of margin is flexible. What is marginal in a sophisticated environment may well be prime in a less sophisticated environment. Each will have its own "margins" of production. Below any "margins", however, land usually lies idle.

Fig. 2 gives a general impression of factors affecting rent and the margin of production.

**T**HE ECONOMIC rent for any and every site will be readily established by the free market. Economic rent is highly sensitive to the variation of a large number of factors which can be grouped roughly under political, economic and Acts of God. Thus the Economic Rent Curve is fluid and will vary from year to year or even overnight. Each variation can have a marked effect on the economy and particularly on employment.

\*David Ricardo defined economic rent in Chapter II of *The Principles of Political Economy and Taxation*. It was also set out by Henry George on page 166 of *Progress and Poverty*. Ricardo's definition must be extended to include all uses of land.

An understanding of cause and effect is basic to an understanding of economics. Two of the three groups of variables are not fundamental to the present study, so only the economic variables relating to taxation will be considered.



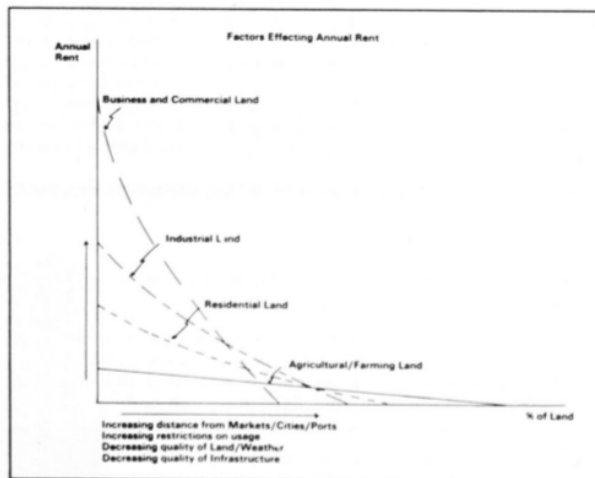
● Fig. 2

**NOTE:** Wages and interest on capital have been left out for simplification in the figures which follow: these will illustrate what happens above the Rent Base Line.

It is necessary to establish a reference point from which the economic rent may easily be assessed for any change in taxation. This reference will be the Natural Rent Curve shown in Fig. 4.

By applying changes in taxation to the Natural Rent Curve, it is possible to estimate with a degree of accuracy the effect on Economic Rent. Any increase in taxation will lower the Economic Rent Curve.

Fig. 4 shows the points where the rent curves intercept the base line and set the position of the relative margin of production.



● Fig. 3

In the absence of taxation, the margin of production would coincide with the Natural Margin. As taxes are levied on labour and capital, these are shifted forward on to natural rent, and the curve of economic rent drops lower and lower.

This, in turn, increases the gap between the Natural Margin and the Economic Margin, putting larger amounts of land out of production and increasing unemployment. Clearly a small increase in the sales tax or PAYE will shift the Economic Margin to the left and increase unemployment. This, in turn, will slow down the economy.

The gap between the Economic Margin and the Natural Margin represents the percentage of land put out of

Turn to P.28



# Editor punches home need for land tax reform

**N**EW HAMPSHIRE editor Dick Noyes is teaching a computer all about land value taxation.

Mr. Noyes, pictured above, has been named by the state legislature's Speaker to serve on a committee which is investigating tax reform.

The Committee to Study Revenue Reform at All Levels of Government will report in May.

And the committee is making use of a privately-funded computer programme set up by a citizen group called the Center for New Hampshire's Future.

The leading options facing New Hampshire are a shift of the property tax on to land values, or the introduction of a five per cent income tax.

Up till now, New Hampshire has prided itself in being the only state to resist a general sales or income tax.

It relies more heavily than any other state on the property tax. And that, according to Mr. Noyes, is the reason why New Hampshire's economy is the strongest outside the sunbelt.

*But there has been a growing demand for property tax relief.*

Now Mr. Noyes, who is Deputy President of the International Union for Land Value Taxation and Free Trade, has pushed for a reform of the property tax.

He wants a state-administered one per cent tax on land values, the revenue from which would go back to cities and towns to equalise the burden of paying for schools.

And in a bid to re-shape the property tax, Mr. Noyes has been learning how to feed information into the computer.

**A** DATA bank, carrying facts and figures about towns and counties and the state itself, has been programmed into one of the main computers at the University of New Hampshire.

What is called a systems dynamics programme – designed to test the probable effects of new taxes through "if-then" calculations – has been structured to help the investigating committee.

Report by  
**JOHN GREEN**

Mr. Noyes has punched in the basic arguments for land value taxation. And he told *Land & Liberty*:

"Initial projections show three things that I had predicted. If population continues to grow, real property tax rates will fall steadily through the century; land values will overtake building values as a factor in the tax base within about ten years; and unemployment will increase if population growth stalls."

And on the basis of what he's learned from the computer, Mr. Noyes says: "They are accurate, fast and stupid. They do exactly what they're told and keep doing it until told to stop! But they are here to stay and we have no choice but to live with them."

He thinks that they can help to reform the property tax if at least half the effort is spent teaching them as has already been spent in teaching people about land value taxation over the years.

MEXICO

## Speculators caught in \$25bn trap

**M**EXICANS bought U.S. real estate worth \$30bn after the 1979 oil price boom.

But exchange controls imposed last August by the Mexican government, to cope with the financial crisis, has trapped many of the property owners.

For they still owe \$25bn on their purchases – but can't get the dollars to finance the deals.

Now the Mexican government has offered to buy the properties off them for pesos in the hope of selling them back to the U.S. for dollars, to increase the country's depleted foreign reserves.

The chairman of a congressional commission in Mexico City says that a law should be passed to stop the flow of Mexican capital into the U.S.

"We can't let this happen again," he said.

## LAND TAX WITH A LONG HISTORY

● AN EIGHTH century Act relating to land taxation which is a quarter of a mile long is housed in the Palace of Westminster. It was recently unrolled – as far as possible – in the Royal Gallery of the House of Lords for the benefit of BBC TV cameras.

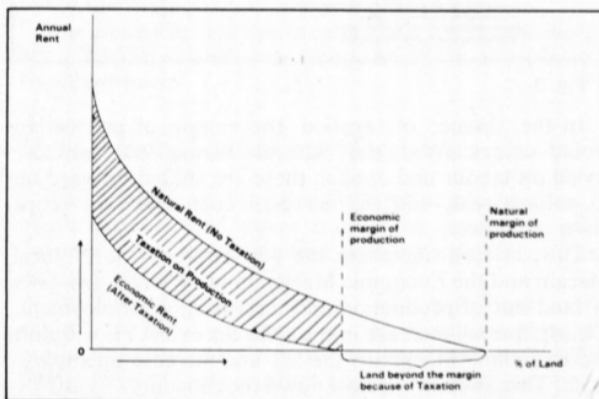
## Doubled up!

● SUNNYVALE, a town in the centre of California's "Silicon Valley", was short of homes. So the council rezoned 131 acres of undeveloped industrial land for residential use. The price of land almost doubled to \$400,000 an acre.

From P.27

production by taxation. Apart from any other effect, it represents a loss of revenue to the State.

When land at the margin is no longer able to meet both increasing taxes and a return for wages and capital, speculators are able to obtain and hold this land for personal pleasure or against a future demand.



● Fig. 4

Speculation in land, as well as taxation, plays a major part in causing unemployment and the two interact. As the infrastructure improves and population grows, total production – and consequently the Natural Rent – increases. But, at the same time, the authorities incur an increasing debt, to finance the improvements demanded by the growing community.

If all land was fully utilised, however, the expansion of the infrastructure would increase the demand for labour. If all labour was fully employed, the Gross Domestic Product would also increase, followed by rises in the Natural Rent.

But the growth in Natural Rent immediately becomes an incentive to speculate in land. By withholding prime land from labour, an artificial scarcity is created, thereby prematurely inflating market prices of land. In this way speculation leads directly to unemployment. But it does not end there.

The Tax Collector normally receives very little, if any, of the increase in land values which speculation brings about, but he loses when production is suppressed.

*Thus a minority of speculators thrive without contributing anything to the economy; it is a case of men being enriched without doing a stroke of work.*

[TO BE CONTINUED]