

See The Cat

By Fred E. Foldvary

A man was walking down a shopping street and came to a store window where there was a big drawing full of lines and squiggles. A sign by the drawing asked, "Can you see the picture?"

All the man could see was a chaos of lines going every which way. He stared at it and tried to make out some kind of design, but it was all a jumble. Then he saw that some of the lines formed ears, and whiskers, and a tail. Suddenly he realized that there was a cat in the picture. Once he saw the cat, it was unmistakable. When he looked away and then looked back at the drawing, the cat was quite evident now.

The man then realized that the economy is like the cat. It seems to be a jumble of workers, consumers, enterprises, taxes, regulations, imports and exports, profits and losses - a chaos of all kinds of activities. Here are fine houses and shops full of goods, but yonder is poverty and slums. It doesn't make any sense unless we understand the basic principles of economics. Once we have this understanding, the economy becomes clear - we see the cat instead of a jumble. We then know the cause of poverty and its remedy. But since most folks don't see the cat, social policy just treats the symptoms without applying the remedies that would eliminate the problem.

What is this economics cat? It starts with the three factors or resource inputs of production: land, labor, and capital goods.

- Land includes all natural resources and opportunities.
- Labor is all human exertion in the production of wealth.
- Capital goods are tools (such as machines and buildings) used to produce wealth.

The owners of land get rent, workers get wages, and the owners of capital goods get a capital return.

Picture an unpopulated island where we're going to produce one good, corn, and there are eleven grades of land. On the best land, we can grow ten bushels of corn per week; the second land grows nine bushels, and so on to the worst land that grows zero bushels. We'll ignore capital goods at first. The first settlers go the best land. While there is free ten-bushel land, rent is zero, so wages are 10. When the 10-bushel land is all settled, immigrants go to the 9-bushel land.

Wages in the 9-bushel land equal 9 while free land is available. What then are wages in the 10-bushel land? They must also be 9, since labor is mobile. If you offer less, nobody will come, and if you offer a bit more than 9, everybody in the 9-bushel land will want to work for you. Competition among workers makes wages the same all over (we assume all workers are alike). So that extra bushel in the 10-bushel land, after paying 9 for labor, is rent.

That border line where the best free land is being settled is called the "margin of production." When the margin moves to the 8-bushel land, wages drop to 8. Rent is now 1 on the 9-bushel land and 2 on the 10-bushel land. Do you see what the trend is? As the margin moves to less productive lands, wages are going down and rent is going up. We can also now see that wages are determined at the margin of production. That is the "law of wages." The wage at the margin sets the wage for all lands. The production in the better lands left after paying wages goes to rent. That is the "law of rent." If you understand the law of wages and the law of rent, you see the cat! To complete our cat story, suppose folks can get land to rent and sell for higher prices later rather than using it now. This land speculation will hog up lands and make the margin move further out than without speculation, lowering wages and raising rent even more.

Now we have good news and bad news. The good news is that when we put in the capital goods we first left out from the example above, the tools and technology increase the productivity of all the lands. If production doubles, rent doubles, and wages go up. Wages won't double, because workers have to pay for the tools, but even if wages go up 50 percent, that's good news, and why industrialized economies have a high standard of living. Also, high skills enable educated workers to have a wage premium above the basic wage level. The bad news is that the technology enables us to extend the margin to less productive land, which lowers wages again. So there is this constant race between technology raising wages and lower margins reducing wages.

It's bad enough that a low margin sets the wage level at the poverty level, especially in countries with low technology and low skills. Government then taxes away a large chunk of those wages, which hurts those workers with higher wages. The result is a highly unequal distribution of income. Workers have the low wage set at the margin and reduced further by taxes, while the owners of land get all the extra production as rent, but pay less in taxes because of tax breaks to landowners. (Capital-goods returns boil down to wages and rents, because capital goods are ultimately produced using land and labor.)

Behold the cat! The margin at the least productive land sets low wages, and the rest goes to rent, resulting in inequality, with poverty for low-skilled workers. **If we see the cat, the remedy is also clear: stop taxing workers, and let everybody share the rent.** If we get public revenues from the rent instead of wages, the public benefits equally from the rent, while workers get the full product of their labor. And wages will be higher, too, because by collecting the rent, we eliminate land speculation, moving the margin up to more productive lands, which raises the wage level. The economy grows faster too, since the government no longer punishes enterprise and investment with taxes, so wages go up faster over time. We all become fat cats.

Those who see the cat have a clear picture of how the economy works. They can see why we have social problems, and what the remedy is. Those who don't see the cat keep trying treat the symptoms with welfare, but they never cure the economic disease. Others see the welfare as not curing anything, and think they can just get rid of the welfare. Only those who see the cat realize that the remedy is a shift of public revenue from labor to land so that we eliminate poverty and thus any need for the welfare state.