

Mason Gaffney Economist, Author



Foreign aid taxes poor people in rich countries to subsidize rich people in poor countries. In the donor country, workers pay most of the taxes. In the recipient country, rich landowners are the primary beneficiaries. Aid raises the wages of workers only if it increases productivity on marginal land. Otherwise, it just adds to the value of high-yielding land, which is owned by a small elite. US corporations contribute to the problem of poverty to the extent that they are landowners. In addition, they invest little of their own capital in other countries. Mostly they just reinvest profits. The system of unequal landownership in Latin America and the failure to develop productive cities is inherited from the encomienda system in the colonial past. North America (except in the southeast) developed in a relatively egalitarian manner, and with productive cities, in large part because land was distributed more evenly than in South America. The key factor in North America was reliance on the property tax instead of taxes on labor. This was also the secret of the development of Singapore and Hong Kong.

Foreign Aid: Reverse Robin Hood

Foreign aid is a process of taxing poor people in rich countries to subsidize rich people in poor countries. It is sold as redistributive, but that is nonsense.

The US tax system is highly regressive. In the decade after 1913, the US taxed mostly the wealthiest households and exempted the middle class. That has gradually changed over the last 90 years. The regressive payroll tax on working people now brings in more money than the corporate income tax. So, when our generous government doles out money to so-called poor countries, it comes from the bottom income earners.

In recipient countries, the primary beneficiaries of that largesse are not poor farmers or workers, but landowners. An infusion of income from outside has little impact on wages, because the standard for wages throughout an economy are determined by the wages of people on marginal land, not by the productivity of labor on the best land. So most economic advances raise the price of land and provide a windfall to wealthy landowners.

How does that work? In most Third World countries, ownership of the best land is highly concentrated. For example, in the Philippines, the mass of the people are pushed off the most productive lands into the hills. In the hill province of Baguio, farmers barely eke out a living on land so scarce that people have had to laboriously terrace the hills. By contrast, the province of Tarlac has rich, flat land where they grow sugarcane. The wage level is about the same in both places. That is because the landowner in Tarlac has to pay workers only as much as someone can earn on the worst quality land in Baguio. The difference between what the better land and the worst land yields is the economic surplus or "rent" of land. The surplus value produced by the more fertile land in the valley is pocketed by the landowners. Foreign aid, which often takes the form of roads or irrigation systems, will not raise wages unless it increases the productivity of workers in the hills. Instead, aid programs are more likely to raise output in the lowlands where export crops are grown. But unless wages are raised in areas of marginal production, such as Baguio, wages will stay the same. Rents will increase, however, which means the price of land will rise. That is why landowners are the primary beneficiaries of foreign aid.*

US Corporate Interests in Developing Countries

When American companies go into a foreign country and acquire natural resources, they do not spend much money up front to get the resources. They acquire them cheaply where tenure or title is uncertain. Then they build up assets in three ways: 1) by firming up their title to the resources, 2) by reinvesting profits rather than bringing in external financing, and 3) by

* Ed.: Gaffney here describes visiting a village in the Philippines at the end of WWII. Gaffney was unable in 1945 to understand the extremely deferential behavior displayed by the local population to the *patrón*, referred to as "The Spanish Master." He told them they did not need to bow and scrape in a democracy. Only later did he understand that deference was not simply a psychological issue, but rather was a direct result of being economically dependent on a landowner.

WHY GLOBAL POVERTY?

profiting from the appreciation of landholdings. The original investment or purchase price is usually the fourth and smallest item. So, US firms own valuable assets overseas, but they represent only a small flow of capital from the US. The value of assets mostly represents appropriation, appreciation, and the plow-back of profits.

Foreign investment does not relieve poverty any more than foreign aid does. The only thing that will relieve poverty is to reform the land markets in these countries. Land markets do not induce the most intensive use of land in the way economic theory predicts. In Latin America, for example, rich, fertile lands are often given over to grazing cattle or sheep, a very low-intensity use compared to cultivation. As a result, the land employs very few people.

Landownership has been likened to a great cartel that excludes people from opportunities, but then does not use those opportunities very efficiently either. Foreign corporations, like the British Vesta Corporation that owns a big chunk of Venezuela, are underutilizing land just as if they were a cartel. Many other companies make extensive, rather than intensive, use of land.

Poverty and Inequality as a Legacy of Colonialism

Landownership and power go hand and hand. To assure their control over territory, colonial powers seized land and divided it among loyal retainers. Concentration of the ownership of land among very few people has been a characteristic of Latin America ever since the Europeans moved in. That is one of the lasting effects of colonialism.

The Spaniards created an institution called the *encomienda* in both Latin America and the Philippines. It was designed to exploit the natives on plantations and to educate them and to proselytize them, all at the same time. They were to pay for their own education and for their conversion to the Spaniard's religion. The *encomienda*, like plantation agriculture in the southeastern United States, was economically sterile in terms of generating urban life, because plantations tend to be self-sufficient. That was part of the idea. Since they produced much of their own subsistence, they had less need of cities. So Latin American cities did not develop as centers of production in the way they did in more vigorous parts of the world. To the extent they did develop, it was for luxury homes of absentee owners.

The *encomienda* system left patterns of concentrated landownership that persist to this day. When wealthy people own the best land and do not use it very well, it almost seems that they are deliberately restricting output and

restricting employment in order to retain power for themselves. Whether they are doing this consciously or unconsciously, the effect is the same.

To understand how colonialism impoverished South America, it may help to contrast Spanish and Portuguese colonies with the English settlements in North America, in terms of concentration of ownership. Adam Smith made that comparison in *The Wealth of Nations*. He was impressed by the vigor of the English colonies as a result of democratic patterns of land distribution and landownership. If he had gone into more detail, he would have discovered that there were marked differences inside the US as well. New Hampshire and Vermont, the most egalitarian parts of New England, contrast sharply with the Southeast, where slavery and plantations dominated the economy.

An economy based on small farmers and craftsmen in North America also created the basis for the development of productive cities, unlike in South America. In the northern and western US there was an association of people in terms of substantial equality. The cities and states in the US that were most successful economically were ones where local governments relied on property taxes, and particularly ones that imposed a higher tax on land than on buildings. Taxing land, not output or wages, was a good policy, because it encouraged building homes, businesses, and service industries. It all worked together synergistically to create a matrix in which industry could grow and cities could thrive. By contrast, the insular plantation society in South America (and in the southeastern US) discouraged the use of property taxes, thus limiting the scope of social infrastructure and the development of cities.

These structural differences explain the prosperity of North America and the poverty of South America much better than the idea that Spain's looting of precious metals impoverished Latin America. If mining gold and silver could make a nation rich, Spain should have grown wealthy, but it did not. It spoiled Spain. The Spanish economy never developed, in part because of the enormous influx of treasure from their colonies. They could get whatever they wanted by flooding the rest of Europe with gold and silver, which had the byproduct of raising price levels during the 16th century. If gaining large quantities of those metals did not generate economic development in Spain, then it follows that loss of gold and silver is not the main reason for poverty in Latin America.

Reducing Poverty

To relieve poverty, better lands need to be put to good use. This is

WHY GLOBAL POVERTY?

especially important for urban land, which is our most valuable natural resource in monetary terms. One square foot in the central business district of a major city is worth as much as a whole farm or a tract of forest land. It employs lots of people, especially in high-rise office buildings or labor-intensive manufacturing.

We normally think of land reform as a process of dividing up farmland among the peasants in small plots. But that does nothing to raise the wages of people on marginal land, the wages that set the standard for the entire economy. Even if the reallocation of farmland will do some good, how can a government pay for it? It is often proposed to impose a sales tax or a value added tax, but that will stifle economic activity in cities and their ability to create jobs. The most important land reform is tax reform of the kind that helped make cities in the US more productive and spread the wealth over large populations.

The conditions for the growth of cities are both simple and complex. But let us make it simple: when you have large numbers of different industries, different people, different activities coming together under terms where they can associate on equal enough terms so that they can interact with each other, you get a tremendous creative ferment that has characterized good cities throughout history.

Taxing land instead of labor is the best way to promote that ferment and to raise wages. Taxing land encourages the highest value land to be put into intensive use, which will create jobs and have a ripple effect throughout the economy.

There are two city-states that applied those principles: Singapore and Hong Kong. When Raffles governed Singapore, he set up a system of taxing land which turned this little island into one of the world's great ports and entrepots (a place to store goods), but also a place to manufacture goods. A similar system of raising revenue from urban land accounts for the development of Hong Kong. Enlightened English administrators deserve a lot of credit for the institutions in those two city-states that made them prosper. Their policies were highly encouraging to production.
