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## The Fatal Mistake

When Mae West told reporters 'I never say "No!" to a good offer', she was not adding yet another one of those sexually suggestive throwaway phrases to the list that made the Hollywood actress famous. She was referring to the land deals that enabled her to build a fortune estimated at around \$45m. Her wheeling-dealing gave the late Miss West a mysterious influence which was immeasurably more powerful than her ability to attract men with her celluloid sex. For deals such as those she shrewdly executed in California's San Fernando Valley are at the source of the problem that periodically afflicts the global economy.

The honey-tongued actress commanded the power to disrupt the productive process because industrial society, quite simply, was built on a mistake. The free market, which Adam Smith called 'the invisible hand', was supposed to be the guiding mechanism which equalised the multiplicity of interests and decisions in the economy; it was supposed to aggregate these in such a way that the potential conflicts between private goals would be removed within a harmonious social framework. The mistake made by the founding fathers of the Industrial Revolution in the 1780s — the inventors of new-fangled machines and the entrepreneurs who capitalised on the new factory-based processes of mass production — was to accept and institutionalise land monopoly. The British people, from the Clyde in Scotland to the Thames in the south-eastern corner of England, brought together human skills and material resources in a unique combination, and built a new economic edifice on a corrupt foundation. The good life for *all* was technically capable of achievement, but was not allowed to be fully realised.

The 1980s are the bicentenary of that quantum jump which was the Industrial Revolution. However, that event, unparalleled in the history of mankind, is recalled not for the pleasing possibilities that it offered, but for the exploitation which ruptured economic relationships and generated social tensions. Over thirty million people are jobless in the industrialised countries; hundreds of millions more, dependent upon the prosperity of the

metropolitan economies for their jobs, are also tramping the streets in the big cities of the Third World. Those who are fortunate enough to be taking home wage packets at the end of the week are nonetheless living with the constant fear that they are the next to be made redundant.

Entrepreneurs — from the captains of multi-national corporations to the self-employed shopkeepers who keep the wheels of commerce ticking over in the corner shops of our High Streets — are equally vulnerable to the pressures of a seemingly pitiless economic system that appears to jeopardise their material welfare no matter how hard they are willing to work.

Everyone is vulnerable, whether he is a capitalist or worker, whether he lives in the 'miracle' economies of West Germany or Japan or the low-productivity countries like Britain. Could it be that the only appropriate response to the malignant forces that undermine the great social institutions and the nuclear family alike is a thoroughgoing revolution — Marxism, perhaps?

The major social and economic friction points derive their existence and logic from the need to compensate for land monopoly, the original structural defect in industrial society. Economists have always skirted around this issue, and have thus been led — by a variety of motives, some honourable (such as humanitarianism), some inspired by the need to protect vested interests — to propose 'solutions' that have merely aggravated the problems. For example, 19th century reformers concluded that poverty could be eliminated through a progressive income tax only; this failed, as the large number of poverty stricken families in the rich nations of Europe and North America would testify (in 1981, 30m. citizens of the richest nation on earth, the USA, were officially classified as living below the poverty line).

The phenomenon of poverty accompanying prosperity will continue as a feature of society so long as we continue to ignore the fundamental problem, which is the failure to deal with the malfunctioning of the land market. Myopically, we will respond to immediate difficulties with short-term solutions designed to ameliorate the effects rather than remove the original causes.

Our investigation celebrates the Industrial Revolution in the belief that reform, rather than another revolution, is all that is required to eliminate repetition of those tragic events that are an indictment of European civilisation.

The thesis examined here is that land speculation disrupts the industrial economy by distorting the distribution of income and contracting the supply of land available for homes and factories, shops and offices and farms. But if we are to accept conventional wisdom, our explanation for the latest recession that began in 1974 and continued into the 1980s is pure nonsense. How can land speculators close down factories, shut High Street shops and throw people onto the dole queues?

We are invited to believe that land, which is fixed in supply, is neutral in the process of production. For example, in his quantitative analysis of the growth of real national income in the western economies, Edward Denison of the Brookings Institution assigns a 0.00% value to land as an input.<sup>1</sup> The only recognition that land might have a negative impact arises in relation to *per capita* income: because the working population is increasing on a fixed amount of land, so land 'subtracted slightly from the growth of national income per person employed'.<sup>2</sup>

From this it follows that the blame for economic recessions cannot be ascribed to those who own the beneficial rights to land. The assumption underlying Denison's view is that land comes onto the market as and when it is required by labour and capital, and that it does so at market-clearing prices determined by competition. This is consistent with the classical theory of perfect competition, but its use for analysing the land market as it is at present constituted reveals a tragic gap in our knowledge.

The causal mechanism is crucial to our analysis, but it is one which even diligent students of the land market have failed to identify. Take, for example, the following account of the West German economy. Investment in real estate via property funds became popular in the late 1960s. This interest intensified into a boom in 1971 and 1972. A slump in the land market followed in 1973, and the 'miracle' economy went into a deep recession in 1974. Are these events no more than a chronological sequence, purely descriptive and with no explanatory content?

The popular explanation for the problems of the 1980s has been the OPEC-inspired rises in the price of oil. As a group, only Marxist economists have consistently denied that the oil price boom in late 1973 initiated the global recession in 1974. Their view is verified by the historical facts; but while *their* alternative explanation is rejected, can we justifiably attribute the burden of responsibility to land speculation? 'Apparently no one has any defensible idea of the relative import played by speculation in contributing to recent land price booms in Canada, New Zealand, Australia, and elsewhere.'<sup>3</sup> We have documented the evidence in four cases — the USA, Britain, Japan and Australia — to defend the view that speculation *was* responsible for the land booms that then provoked the general recession as a result of the unbalanced flow of land onto the market, the distortion in the production costs of firms and the reduction in the spending power of households.

The power to engineer these effects is identified as corrupt. In theory and practice, land monopoly is inconsistent with *laissez faire*: the free market cannot hope to function effectively if it is undermined by a class of people who are not subjected to the rules of competition. Psychologically, land monopoly stimulates the something-for-nothing attitude which serves no justifiable economic or social purpose. Morally, land monopoly is indefensible

because it assigns the power to reap the rewards of other people's labours.

Past attempts at resolving the instabilities in the industrial system were doomed to failure because attitudes and knowledge had been distorted by the historians, economists and politicians who neglected the crucial role of land in the productive process.

The classical economists defined the production function in terms of three factors: land, labour and capital. This was subsequently simplified to capital and labour. The analytical concepts, conforming to the perceptions of 'real-world' economists, were adjusted to take account of what was held to be the diminishing importance of land in the dynamic process of urban-based industrial production. 'Land' was conflated into the concept of 'capital', its unique characteristics thereby distilled out of sight. This freed the minority of people who monopolised land to exercise a devastating influence over the course of production, for which capitalists bore the blame. Their activities were secreted behind a veil of ignorance; the connection was lost to the economic doctors who declined to examine all the symptoms. As a result, their prescriptions were muddled and incapable of curing the psycho-social deprivation and material suffering of generations of workers who had the ground cut from beneath their feet.

Thus, the capitalist system appeared to be anarchistic; there was no reliable long-term stability. Is it beyond the wit of man to find a permanent solution to the booms and catastrophic depressions that periodically return to rupture efforts to build a free and prosperous society on the basis of growth sustained over a long period of time?

The task of finding such a solution is urgent, for capitalism is challenged by the socialists whose concepts have been fashioned by Karl Marx. They argue that economic crises are evidence of those 'internal contradictions' which represent the opportunity to revolutionise society. Rational planning would be substituted for the disorder of the market. The Marxist critique has an undeniable plausibility (given present perceptions) which makes it attractive.

It will always be one of the most appropriate criticisms of free enterprise society that it is quite unable — or rather, unwilling — to use collectivist forms of economic organisation for an attack on slums, poverty, disease and lack of education, while it is able to use all those techniques, repugnant as they are to the business man's mind, when it comes to war...<sup>4</sup>

Thus, subtly, we are presented with the assumption that only collectivist action can solve these problems. Superficially it appears reasonable, for many people lack not the will but the means to act for themselves in their own interests. Because of the persuasiveness of this assumption, we trundle inexorably into corporate and collectivist action while paying lip-service to liberal philosophy based on individualism.

The language in which these issues are debated determines the way in which we construct the answers. Research and policy-making is heavily conditioned by one simple image: the 'class conflict' between capital and labour, a notion lovingly nurtured by Marxists which has been left unchallenged by the ineptness of liberal economists. The Machine exploits Man. Trade Unions exist to Bash the Bosses. And so on. This fraudulent prospectus has dictated the terms of all the reformist debates of the past hundred years. As a consequence, we have been tackling our economic problems in the wrong way because we have perceived them through a prism of language which distorts reality.

A book that rejects the Marxist critique has to accomplish two things if it is to advance the cause of a prosperous liberal society. First it has to exonerate the free enterprise model of the criticisms levelled against it. This does not mean that the individual actions of all capitalists have to be defended, but we do have to show that material deprivation is not a systemic feature of free enterprise (in the way, for example, that the individual's freedom to make decisions is necessarily eliminated from a system that is built on centralised planning). Then, we have to demonstrate that the major economic problems can be remedied while preserving individual freedom; that people who wish to work can earn good incomes with which to finance their needs without placing themselves in a state of dependence on a bureaucracy and public welfare subsidies. How can these ideal goals, which have eluded us for two hundred years despite the strides in science and technology, now be achieved?

Intuitively, people believe that the answer lies buried somewhere in the tax system, which redistributes income, shapes incentives and apportions power. In this they are right, but what changes, in particular, ought to be promulgated? A straightforward programme of tax-cutting is the general answer. President Ronald Reagan and Prime Minister Margaret Thatcher were both elected to office with a remedial programme based on this proposal.

The philosophy under-pinning this approach goes as follows: manifestations such as unemployment are proof of insufficient free enterprise; instability is attributed to a lop-sided economy based on the growth of the public sector; this public sector participation in the economy should therefore be reduced drastically by cutting taxes and reducing direct state involvement in the operation of firms and the lives of families.

This interpretation does not account for the fact that industrial economies have *from their inception* regularly over-stretched themselves into depressions. Each of these boom-slump cycles lasted for two decades, and their main elements have been consistently replicated. The first British cycle (1795 to 1815), which is analysed in Chapter 4, bears striking resemblance to the most recent cycles. Yet during the earliest cycles on both sides of the Atlantic, state

interference in the economy was minimal or non-existent. So the uninformed analysis — that we need more of the same capitalism, and less welfare statism — is sterile as an explanation of the underlying problem. There was no golden industrial age to which we can return; we have to look for one in the future. But to find it, we must first identify those injurious causal influences which are common to all the depressions from 1815 to 1975, if they exist. Only then can we define reforms of lasting value.

But even if we are armed with the correct diagnosis of the problem, the definition of a solution would be no easy matter. This is because, for at least two millenia, fiscal policy has been bedevilled by a tendency to avoid coming to terms with the harsh realities of tax policy if — as is inevitably the case — it affects some vital interest.

There are two indivisible sides to the distribution of wealth through social mechanisms: equity and efficiency. Primitive societies fused these two aspects into coherent codes of practice which were consistent with their resources and level of development. This happy state of affairs dissolved with the rise of classical civilization. We have, ever since, been groping for a formula that served the ends of both justice and the optimum needs of the prevailing mode of production, but with little or no success. There is no Sermon on the Mount, or set of rules inscribed on ancient tablets handed down from on high, on which we can draw for guidance.

There have been some ideal opportunities in modern times for redefining the legitimate claims of the public domain on private wealth, but these have been tragically wasted. The American Founding Fathers, for example, had such a unique opportunity. Their perspicacity is exemplified by James Madison, father of the Constitution and fourth President of the US, who put his finger on the problem when he declared in No. 10 of the influential Federalist Papers:

The most common source of faction, the most durable, has been the unequal distribution of property.<sup>5</sup>

He identified the problem, and noted the risks of dominant groups using tax legislation to 'trample on the rules of justice. Every shilling with which they over-burden the inferior number is a shilling saved to their own pockets'.<sup>6</sup> But he then proceeded to intimidate future generations of lawmakers in Congress by attacking as a 'wicked project' any attempt at an 'equal division of property'.<sup>7</sup> By failing to specify how to deal with the most serious problem in civil society — 'the unequal distribution of property' — he immediately preached against a philosophy that might have produced a fiscal policy to neutralise the consequences. And so the New World, populated by refugees on the run from the old tyrannies that were built on

the enclosure of common lands, began to recreate those very conditions that had led to the exodus from Europe (see Chapter 10).

What of the canons of taxation provided by Adam Smith? These are generally regarded as profound, and are still cited by free market economists as the guidelines for fiscal policy. But as we shall see in Chapter 2, Adam Smith suffered from the shortcoming that led him to a set of prescriptions which prove, to the present author's satisfaction at least, that he lacked that 'most exact impartiality' which Madison considered to be crucial to the making of tax laws. What, then, do we propose as a third alternative to the limited choice at present on offer from right-wing Conservatives and their opponents, the Marxists?

The major reform that we prescribe is a 100% tax on the annual rental value of all land and a simultaneous reduction in other forms of taxation. In other words, we advocate the 'socialisation' of all ground rents to remove private gain therefrom, but would give free reign to private enterprise within what would now be a free market system. This proposal is not original: in its full-blooded form, it was propounded by Henry George in *Progress and Poverty* (1879).<sup>8</sup> Is it eccentric to suggest that a single tax advocated over a hundred years ago contains the solution to contemporary problems? Readers will judge once they have acquainted themselves with the evidence. Suffice, for the present, to note the seminal importance of this book, which has become economics' leading best-seller.<sup>9</sup> Paradoxically, today few readers will be familiar with the book, yet it continues to wield influence in the councils of power. We can see this, for example, from the strictures on taxation expressed by President Reagan's economic guru, Dr. Arthur Laffer. The Californian professor promoted the 'supply side' economics that were at the heart of the Republican presidential campaign in 1980.

The Laffer Curve, as it became known, is based upon the principle that savings and investment are most likely to accrue to expand productivity when the government is not taxing the people down to the last penny that can be squeezed out of the private sector. Dr. Laffer's authority on fiscal policy is Henry George, whose canons on taxation were 'the essence of what we are talking about', according to this presidential mentor.<sup>10</sup>

Henry George's analysis culminated in a condemnation of land speculation. He advocated a single tax to capture all economic rent for the community's benefit, and the simultaneous elimination of taxes on labour and capital. President Reagan was not ideologically disposed to carry out the full Georgist fiscal programme, however: he had made a million himself out of Californian land deals!

Henry George was called The Prophet of San Francisco. The label was appropriate. He was a fine orator, and his book was written with an unmistakable passion which fired the imaginations of people around the

world who sought a practical philosophy which would enable them to both preserve individual liberty and yet restore that primitive cohesion which is vital to a healthy society. The message in *Progress and Poverty* was a simple one. Natural resources have no cost of production, they are God-given, and so they legitimately belong to everyone. The most efficient way of securing a fair distribution of resources is through a tax on land values. Every citizen has a stake in the revenue which then flows into and out of the exchequer coffers. If the government levies that tax and spends the money on socially-necessary projects, there is no need to interfere with the liberties, economic activities or property of anyone; people know what they want and are capable of securing these for themselves *provided that there is no monopoly of land*.

Henry George thus advanced, in addition to his moral theory of property, the hypothesis that a free enterprise economy could operate efficiently only if economic rent was completely taxed out of the arena of private enterprise. The statistical data was not available to enable him to test his theory empirically. He had to rely on impressionist evidence. Even today we are not much better off, for while statisticians spend a great deal of time and money in collating data on capital and labour, they all but ignore the land. This encourages economists to neglect George's macro-economics. For example, Professor Samuelson — in one of the most widely read student textbooks on economics published in the postwar years — reduces Henry George's problematic to an ethical one. The case against private land ownership 'must be attacked or defended in terms of ethical value judgments concerning the proper FOR WHOM resolutions in society'.<sup>11</sup> The *economic* case against the present land tenure system is side-stepped.

Here we shall try to ignore the ethical arguments (not always successfully, as some of the language will reveal). Our purpose is to explore the scientific proposition that land monopoly, and not the free market, must accept the blame for the poverty and human degradation in industrial society.

The enquiry necessarily begins with the 'bible' of the free market, Adam Smith's *The Wealth of Nations*. This was the book that provided the captains of industry and the politicians in Westminster (a body largely composed of landowners) with the theoretical framework and moral justification for the new mode of production. What we discover is that the advocates of capitalism failed to elaborate a scheme that would enable them to attain capitalism's full potential. So for two hundred years the entrepreneurs and their employees have laboured within the framework of an impure model.

This has served the Marxist critics well, for they have been able to attack the *laissez faire* ideal by marshalling evidence derived from a seriously malfunctioning system. That they were pointing to a crippled capitalism has not been an argument used in defence of the free market.

We, in defending the need to establish *laissez faire*, maintain that land



monopoly is not one of its intrinsic characteristics. The private appropriation of the *value* of land (as opposed to secure individual possession and use of specific sites) is not a necessary condition for the capitalist mode of production. Capitalism entails the accumulation of wealth based on the provision of goods and services to consumers. It is a two-way exchange: consumers produce wealth in order to exchange it with others — to consume. Land monopoly undermines this creative process because it is a one-way relationship. The monopolist secures legal title to the resources of *nature*, and then claims a portion of the wealth created by others in return for nothing more than the permission to use land. This is the economics of the bandit sanctified by law. The monopolist *per se* does not contribute to production; he is, therefore, an anomalous feature within an otherwise efficient system.

Unfortunately for the free market, even its champions have not served it well. Now, with the eclipse of Keynesianism, we are back in the philosophical vacuum that has regularly afflicted Western society. The political dangers, as we pass through a recession that equals the one of the 1930s, are well known. We do not believe that it was a coincidence that the Japanese government's White Paper in 1981 contained repeated calls for greater 'patriotism', or that in 1982 Japan began to sanitise her military history as the sun rapidly set on the miracle economy.<sup>12</sup>

In the desperate search for explanations and solutions, liberal economists have sought refuge in the theory of a Soviet economist, Nikolai Kondratieff. In 1925, he postulated that capitalist economies rise and decline in 'long waves' of about 50 years duration.<sup>13</sup> The global economy is supposed to be in the trough of the latest such cycle. This view has produced exercises in exhaustive statistical compilation, some of them scholarly,<sup>14</sup> others popular treatments which the authors admit could be interpreted by scientists as smacking of the occult.<sup>15</sup> The problem with Kondratieff is that he did not offer an *explanation* for his cyclical phenomena. Yet without explanations it is impossible to equip the politicians with a package of rational corrective policies.

Unlike the mono-causal theory presented here, analysts who have built on Kondratieff's work have come up with a choice of 'various theoretical explanations'.<sup>16</sup> This choice has not convinced the decision-makers that they are now within reach of a practical solution for the major schisms in the growth trends that occur more regularly than every half-century.<sup>17</sup> The editor of *The Times*, the newspaper of the British Establishment, noted with candour in his valedictory message to his readers:

The truth is that nobody knows the best way to manage the worst world slump since the 1930s (for economic historians it is a casebook example of a Kondratiev 50-year recession) in a period of endemic inflation. There is no answer in Keynes or Friedman or Marx or anyone else...<sup>18</sup>

Not surprisingly, therefore, politicians are today floundering around indecisively. The debate about how to regenerate the global economy is conducted in over-simplified terms. On the right hand, the conservatives advocate a 'supply side' strategy: revival through higher investment and output of goods and services. Economic liberals, on the left hand, are moved by desperation to cautiously propose a demand-side strategy: a return to government pump-priming, which brings with it the risk of new inflation.

This debate of the deaf is doomed to ultimate failure. This is predictable, because each side is offering a partial truth, recourse to which in the past has produced the state of disarray in which we find ourselves. Reducing interest rates (to stimulate investment), or increasing public expenditure (to increase demand), may have beneficial short-term effects; the passage of time, however, shows that they are of little more value than the placebos handed out by doctors who do not know the cause of the illness that they are invited to cure, but are too vain to admit of their ignorance to their patients.

It is this piecemeal tinkering with parts of the economy, however, which, cumulatively, has built up heavy income taxes, insupportable government deficits, overwhelming disincentives to the wealth-creating processes and has permitted cyclical collapse of the system. They are all hopeless attempts at mitigating the original problem. For too long, now, 'managing the economy' has been a substitute for a radical solution. While it provides power for politicians and jobs for civil servants, it does not create social stability and new wealth. That will be accomplished only when we finally come to terms with the monopoly of land, the one factor which is traditionally omitted from all the equations.

Because we have failed to address ourselves to this major problem, the door has been opened to the extreme left. They triumphantly claim that the capitalist system is about to terminate in one of those epoch-making Big Bangs that constitute the saltatory Marxist theory that history moves in stages, with communism at the pinnacle of human social achievement.

But if, as we claim, land monopoly is not an intrinsic 'contradiction' within capitalism, the corrupting influence can be surgically removed without recourse to social transformation. We do not claim that the fiscal reform recommended here will create an economic system at its best and final stage in human organisation. But capitalism would be equipped to ensure full employment and sustained prosperity, and so able to resist its ideological enemies and last much longer than they would have us believe.

Marx regarded capitalism as the last antagonistic form of class society. Fiscal reform would lay the foundations for the removal of the antagonistic elements and enable us to refine liberal democratic society. This is a sweeping claim, the full justification for which is not elaborated in this book. Other works will have to follow. Meanwhile, establishing how the speculative

booms and disastrous slumps can be eliminated from the industrial economy is the first and necessary step in the direction of a happier and more prosperous society.

## Notes

- 1 E. F. Denison, 'Economic Growth', in *Britain's Economic Prospects*, by R. E. Caves and Associates, Washington, DC: Brookings Institution, 1968, p. 236.
- 2 *Ibid.*, p. 251.
- 3 D. Hagman and D. Mischynski, *Windfalls For Wipeouts: Land Value Capture and Compensation*, Chicago: American Society of Planning Officials, 1978, p. 123.
- 4 J. Steindl, 'Capitalism, Science and Technology', in C. H. Feinstein, editor, *Socialism, Capitalism and Economic Growth*, London: Cambridge University Press, 1967, p. 200.
- 5 *The Federalist Papers* (Introduction by C. Rossiter), New York: The New American Library, 1961, p. 79.
- 6 *Ibid.*, p. 80.
- 7 *Ibid.*, p. 84.
- 8 H. George, *Progress and Poverty*, centenary edn. 1979, New York: Robert Schalkenbach Foundation.
- 9 G. Gilder, *Wealth and Poverty*, New York: Basic Books, 1981, p. 42.
- 10 J. Rees, 'Supply-Side Economist Arthur Laffer', *The Review of the News*, 6.11.80, pp. 47-49.
- 11 P. Samuelson, *Economics*, Tokyo: McGraw-Hill Koga Kusha, 10th edn., 1976, p. 568.
- 12 Among other emendations, school textbooks — with the approval of the Ministry of Education — were altered so that the Japanese 'invasion of northern China' was made to read 'advance'. The description of how Korean labourers were forcibly sent to Japan was changed to read 'mobilized'. The diplomatic row that ensued from this reappraisal of history forced the Japanese government to back-track. The new nationalistic mood, however, was firmly established. We cannot predict what this portends for Far Eastern relations. What we do know, however, is that a new 5-year plan for military procurements was adopted, and that there was a proposal to increase the 1983 defence budget by 7.3% (to £6.29 bn.)
- 13 N. D. Kondratieff, 'The Long Waves in Economic Life', *Lloyds Bank Review*, October 1978.
- 14 For example, W. W. Rostow, *The World Economy*, London: Macmillan, 1978.
- 15 J. B. Schuman and D. Rosenau, *The Kondratieff Wave*, New York: Delta, 1972, p. viii.
- 16 W. W. Rostow, 'The Long Waves in Economic Life', *Lloyds Bank Review*, July 1979, p. 53.
- 17 Ray admits that 'no more than guesses can be expressed' in the search for the motive power that might drag the British economy out of the Kondratieff trough and into a new phase of sustained growth. G. Ray, 'Innovation in the Long Cycle', *Lloyds Bank Review*, January 1980, p. 26.
- 18 W. Rees-Mogg, 'My resumption of liberty', *The Times*, 7.3.81.