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Marxist Theory and Soviet Experiment

Nationalisation of the means of production was the socialists' catch-all solution to the shortcomings of 19th century industrial society. The instability of the capitalist system could be rectified by the public sector. An enlightened bureaucracy equipped with planning powers was popularly believed to be the most effective instrument for dealing with the afflictions of cyclical crises that were internal 'contradictions', harbingers of the imminent collapse of private enterprise.

Yet when Henry George emerged to shape political philosophy in the 1880s, there was a prospect that Western capitalism would be reformed internally, made consistent with the original Smithian tenets of a free market, private enterprise and consumer sovereignty. Although Karl Marx scorned *Progress and Poverty*, calling it 'the capitalist's last ditch',[1] the book raised the level of popular awareness of economic issues. The consciousness of radicals of the left was certainly heightened. From Eugene V. Debs, the Socialist Party presidential candidate in the USA, to Sidney Webb in Britain, they acknowledged a debt of gratitude for the new visions opened up by Henry George. George Bernard Shaw observed: 'When I was thus swept into the great Socialist revival of 1883, I found that five-sixths of those who were swept in with me had been converted by Henry George'.[2] In 1884, Frederick Engels predicted 'a meteoric role' for George.[3]

Marx himself poured scorn on the use of the concept of economic rent, which he regarded as a category of bourgeois economics.[4] Nonetheless, he saw that land materially contributed to the process of production. In the agricultural sector, soil fertility could produce unequal yields from two plots of land of equivalent size onto which identical labour and capital inputs had been deployed. Rent as a surplus income, however, was determined by the market, in which competition equalised prices down to the costs of production. And this model did not find acceptance within Marx's ideological system.

The virtue of the competitive market model is that it enables the decisionmakers to calculate the relative contributions of various factors, and so maximise efficiency. Orthodox Soviet economists, however, preferred to hold the view that only workers created wealth, an illusion inspired ironically, by Marx's treatment of the labour theory of value in Vol. 1 of *Capital*.[5]

The Soviet wisdom, however, is a vulgarised form of Marxism. Marx himself did not exclude land from the process of value-creation. His description of rent in Vol. III of *Capital* is a valuable contribution to economic literature. And in his *Critique of the Gotha Programme* he firmly declared: 'Labour is not the source of all wealth. Nature is just as much the souce of use-values (and surely these are what make up material wealth?) as labour'[6]. To achieve optimum efficiency in the allocation of resources, it is necessary to have an accurate measure of the relative contributions of the different factors of production. The market solution to this problem was unacceptable to Marx, but this was because he had failed comprehensively to appreciate that land monopoly was the fundamental source of the problem: his solutions consequently addressed themselves to secondary issues.

Accordingly, the natural riches which fell under the geo-political influence of Moscow have been systematically squandered. The dogmatic view of Marxist economics had prevailed. Because land was not a product of labour, it was not accorded value. And so for 60 years the costs of its use were not taken adequately into account by the planners.

But the result has been more than a profligate use of natural resources. The failure to attribute accurate rental value to each and every piece of land, rural and urban, distorted the allocation of capital and labour. Bad investment decisions have been responsible for an unquantifiable degree of waste. For example, Soviet economists have calculated that the annual losses caused by the maldistribution of buildings alone in the USSR amounted to 1,000m. roubles in the early 1960s (over 0.5% of national income).[7] Extensive rather than intensive use of land was the order of the era. Volume of output rather than value of production, efficiency and quality, has been the guiding principle and yardstick for success. By spreading available resources far and wide in their dash for growth, the Soviet planners condemned the citizens to lower living standards than were otherwise attainable, and to deep-seated problems — such as soil erosion on marginal agricultural land that ought never to have been tilled — which could have been avoided.

The miscalculations were due entirely to the absence of those economic signals which, in the free market, are known as prices. Marxist planners have had to rely on their intuitions. The role of intuition in the extensive investment of capital in the Polish iron and steel industry over the period 1961-65 has been studied. One-third of the investment projects was based on intuition and 'guesswork', one-third was partly documented and no more than one-third was properly worked out and supported by documentation.[8]

The Polish experience is illuminating. The attempts to fulfil the aspirations of the Polish workers in the 1970s were valiant, but they were bound to fail. Billions of borrowed dollars were poured into new investment projects. But according to Wilczynski:

> The omission of land made the initial effectiveness of the investment outlay appear unduly high, because the increase in production seemed to be due only to this outlay, as if there were no contributions from land. Then, additional investment outlays on labour and capital appeared to lead to disproportionately low increments to production in the project in question. This only exaggerated the extensive approach to investment, because new projects on other land promised higher returns on paper.[9]

The misdirected investment resulted in the crisis in industrial relations in 1980, culminating in the victory for Lech Walesa and Gdansk workers who led the demand for free trade unions.

Edward Gierek, the Communist Party leader, had come to power in 1970 as a result of widespread social discontent. His programme of massive investment landed the country with a $20bn. foreign debt without raising living standards because the resources that flooded into the country were not put to their best use. Gierek was bound to fail, because of the adherence to Marxist methodology rather than through a lack of good intentions. In public statements the Communist leaders finally admitted that there had been serious economic mistakes, especially in relation to the investment programme. Shortly after Gierek was replaced as party leader, Henryk Kiesel, the Planning Commission chief and former Finance Minister, confessed that 'ineffective investments' contributed to the crisis.[10]

On August 30, 1980, the Polish Communist Party endorsed the demand for free trade unions and the workers' right to strike. This was the first major fissure in the hegemonic power of Moscow's communist ideology. Poland's auto-critique was subjected to an orchestrated attack from other European communist leaders. But the economic lessons were not lost on the Chinese communists, who followed a Marxist line that was independent of Moscow. In the following month, the Chinese abandoned their 10-year Plan because — according to Chairman Hua Guofeng — its target aimed 'too high, the scale of capital construction was too large and comprehensive balance was lacking'. Marxist national accounting had enabled the Eastern bureaucratic planners to set goals that were not realistically underpinned by the costs of the available resources. The extensive spread of these resources led to a miscalculation that did not augur well for the experimental return to economic co-operation with the West. The events in Poland quickly compelled Peking to review her strategy. During the four months leading to the announcement of an interim budget in March 1981, the Chinese Government cut the allocation for capital construction by 40% from around $36bn. to about $20bn.[11] Among the projects identified as wasteful and mislocated, and which was subject to a severe cutback, was the $2.4bn. Baoshan iron and steel complex.

The economic inefficiency of the Marxist methodology has been emphasised, but could this be an acceptable price to pay, if communism nonetheless secures social justice in the distribution of natural resources? We have, after all, censured the Western model because of its inequities in the distribution of unearned rental income. Has this problem been solved in the East? Yugoslavia presents us with a fair opportunity to weigh the question, because she is not dogmatically plugged into the conventional wisdom of Moscow, she recognises market incentives for workers, and yet constitutionally she indubitably harbours socialist egalitarian ideals.[12]

Here we find two distinct land markets. Rural land is operated almost entirely on Western principles. About 85% of the land is privately owned. There are legal limits to the size of individual holdings, ranging from 15 hectares for arable land up to 70 hectares on poor-quality land in hilly terrain. As in the West, owners of land on the periphery of urban centres have been replacing their farming activities with the inert role of the speculator, dividing up their holdings and selling off parcels to town-dwellers. The compensation paid to owners for land that is expropriated for public-sector purposes is calculated on the basis of free market values. In theory, that part of land value which can be attributed to natural or social factors — such as the existence of infrastructural facilities, the demands for land from urban areas, irrigation installations, etc. — are deducted from the compensation. If applied consistently, this would mean that the whole of economic rent would be removed, leaving the farmer with the value arising from his capital and labour investments. In fact, however, the farmer does retain part of Ricardian rent.

The urban economy fuses socialist planning with the unique Yugoslavian system of self-management and individual incentives. Proprietary rights in urban land, however, were nationalized in 1958. The law applied to 860 towns and various industrial, mining and tourist centres. By 1980, nearly 50% of the population lived in the country's 510 major municipalities. The policy aimed to provide land at the right time, in the right place and at the right price (taking into account both social and economic criteria).

In theory, there was no room for private appropriation of economic rent. One official exception was allowed to this rule. A municipality could waive its right to appropriate economic rent if the land user agreed to invest the money in socially useful projects such as new factories or urban infrastructure. Otherwise, the municipality levies a tax on rent to redistribute the surplus value between all its citizens through the public sector. This ethic is egalitarian, but does it work in practice? The answer is in the negative, and the failure arises from the inadequacies in the structure of the socialist economy.

Officially, there is no market in urban land. Rents are determined according to bureaucratic criteria. These criteria are arrived at on the basis of 'intuition'. They include location, availability of infrastructural facilities and recreational amenities, environmental attractions, and the general quality of urban life. The urban area is then divided into residential and commercial zones. Monthly rental payments are computed on the basis of so many dinars per square meter of floor space. The dinar rate is uniform throughout the zone, irrespective of variations in the characteristics of individual plots within a zone which influence the real economic value of land.

The result of the application of the subjective intuitions of bureaucratic planners, however, is that the rents actually paid by those who possess land are less than the true economic value of the sites. Consequently, the belief that there is no market in land values is a constitutional fiction: a black market emerged to enable the possessors of land to exploit economic rent.

This is what happens. Urban land users own the buildings (homes, shops and so on). In the residential market, each individual can own two large or three small apartments. When they decide to sell, they add a premium onto the price of the structure. This premium is the capitalised value of that part of economic rent that is not appropriated by the municipality. The premium represents the value of the land as perceived by the prospective occupiers of the site. *They* know how to put a cash value on the attributes of the land, and they do so on the basis of competing with other prospective users. The highest realistic premium which this black market is willing to realise is the capitalisation of economic rent, after discounting for the monthly rental payments which the possessor is obliged to pay to the community for the privilege of possession.

The value of land in Belgrade rose rapidly in the 1960s. The municipal authorities, because they had to rely on their intuitions, were not able to track the movements. The available statistical data was inadequate. As a result, the municipalities did not rapidly adjust their rental charges upwards. Had their land taxes risen in line with real values, the selling price of land would have been zero (the constitutional theory). In fact, individuals and institutions had to pay considerable sums of money to get the land they needed for commercial and manufacturing activities (the economic reality).

Four deficiencies in the Yugoslavian model can now be highlighted.

1. The intention of socialising urban land values has not been achieved. People in favoured locations are able to retain significant portions of economic rent. We find, therefore, in a socialist economy, the institutionalisation of economic inequality based on the failure to use free market principles. An increase in municipal land taxes would enable Yugoslavia's

economy to grow faster, through the reduction of income taxes. This would meet what Dr Janić, the Director of the Yugoslav Institute of Town Planning and Housing, called 'The absence of a market for many urban goods and services'.[13]

2. Inequities exist between land users. Because the monthly rent payments are based on a crude calculation, they fail to take account of all the factors which in a free market would influence the decisions made by individuals. This can be illustrated with location and the costs of transportation. Some people in favourably located residential areas save on the money they have to pay to travel to work. Others, in outer areas, have to bear extra costs of transportation. In a free market, these additional costs would be taken into account when determining the economic surplus available for payment of rent. But in Yugoslavia there is official discrimination in favour of the privileged. Again, this is an unintentional byproduct of the system for determining land values.

3. The land tax is actually a general property tax. Monthly rental payments fall not just on land but also on capital improvements upon it. The rent is calculated on the basis of so much per square meter of *floor space* in the building, and not by the square meter of occupied land. The physical expansion of premises is thereby discouraged, at the expense of improved productive capacity.

4. Scarce capital resources are not efficiently allocated because of the rigidities in the land market. People who occupy land but fail to put it to optimum use are under no fiscal pressure to take action. In fact, the longer they wait, the higher the premia they can eventually extract from others. There is, then, a positive inducement to inertia in the occupation of urban sites. Potential users are excluded from desirable locations, and the overall result is an economy producing fewer consumer goods and services than would otherwise be possible.

By the turn into the 1970s, the municipal authorities grew alarmed at the way in which citizens were able to manipulate the land market to their advantage. Had a realistic annual land tax been levied, there would have been no financial incentive to speculatively postpone the sale of houses.[14]. The 'remedial' action in 1972 was to increase to nearly 80% the tax on the gains from the sale of residential properties. House owners resisted the tax by declining to sell. The house market dried up. Owners were aware, of course, that by sitting tight they would eventually win. The value of the land which they occupied would continue to rise, along with the premia they would charge for moving out. By 1980, the municipal authorities were persuaded that they ought to reduce the tax rate to stimulate the sale of houses. The socialist land speculators — the ordinary home-owners — were winning.

According to the Yugoslavian constitution, land is a resource which had to be managed rationally in the social interest. The absence of effective market prices (which constitute signals based on the incomes and preferences of all citizens) thwarted this principle. In the early 1980s, the Yugoslav Institute of Town Planning and Housing in Belgrade set about promoting objective criteria for measuring surplus income (rent). This objectivity, however, was still based on bureaucratic criteria. Empirical research was conducted which suggested that the turnover of commercial enterprises was a good indicator of urban rents, and could therefore replace the subjective criteria developed by the intuitions of the bureaucrat. But while this might tell the municipal authorities something about the prosperity of commercial areas, it still leaves a big gap in the knowledge of the tax authorities about the industrial and residential areas.

Marxist economists may now be awakening to the need to put realistic prices on land which could then be taken into account in project-appraisals. But the analytical tools at their disposal are shaped by ideology. The bureaucratic planner's method of cost-accounting, rather than market-determined prices, are still officially endorsed as the desirable system for adoption. As a consequence, the Soviet approach to socialised land will continue to retard the optimum use of productive resources and so fail to raise the level of consumer satisfaction. Not until the Marxists revise their attitudes towards the concepts employed by 'bourgeois' economists will they have reached the stage where they can begin to exercise value judgements about a fair and effective system of social and economic organisation.

The dishonesty that underpins Marxist economics can be illuminated by examining the Soviet housing sector. It illustrates the size of the distortions arising from the failure to measure and charge the full market rent. A privately rented flat that costs £47 a month would be rented out by the public sector for £5.[15] Low rents are considered an achievement of 'real socialism', and were laid down in 1928 at the rate of one square metre of living space for the equivalent of 10p. In those days, this would represent 10% of a family budget, whereas today it takes on average 2%.

Subsidised rents cost the USSR £5.5bn. a year. The deception is that citizens are told that the State provides the subsidies that enable them to live cheaply. The reality, of course, is that wages are centrally fixed at low rates, so that the resources can be used to provide public housing. All that has happened here, is that the bureaucrats spend the income instead of the citizens; they exercise the choices that are (or ought to be) made by individual consumers in the West.

Thus, although the Western model built on the existing land tenure and fiscal system is deficient, reformist solutions will not be found by moving geographically or philosophically eastwards.

It is a tragedy that, 200 years after the industrial revolution, it should be necessary for us to even contemplate whether lessons could be learnt from the Marxists. This suggests that Western liberal democracy is inadequately equipped to handle the scale of the reforms that are necessary if capitalism is to survive in a recognisable form. This would be an incorrect assumption, for change along the Georgist lines became a prospect in Britain. Ironically, the socialists were instrumental in preventing the internal reform: the story is worth recounting briefly in the context of this appraisal of the prospects of permanent reforms within a socialist framework.

The British Liberal Party, which dominated Parliament for most of the years at the turn of the 19th century, wrote George's land tax into its constitution. In the early years of the 20th century, distinguished Liberals like Winston Churchill took the message to the hustings.[16] As the most mature of industrial economies in the world, Britain was ripe for the experiment. But while the political will was present, the grasp of economic fundamentals was lacking. Lloyd George, the Chancellor of the Exchequer, simply did not know what he was about.[17] The House of Lords chose to make their final stand in defence of their aristocratic control over landed property; the gauntlet was picked up by the commoners, who trounced the opposition through the ballot box. Lloyd George, however, in his 'People's Budget', introduced duties on land that bore no resemblance to the land value tax recommended by Henry George.

The bungling by the Parliamentary draftsmen who produced the Act in 1910 that sought to introduce the 'land value taxation' system has been analysed by Sir Edgar Harper, the Chief Valuer to the Board of Inland Revenue who had an intimate knowledge of those fateful years.[18] After a gruelling 10 years, the attempt to institute land taxation as a coherent fiscal policy was abandoned. This was not surprising. Instead of using the 'market value' definition for land values, the Act introduced five different values which had to be determined for each property: Gross Value, Full Site Value, Total Value, Assessable Site Value and the value of the land for agricultural purposes. There were four duties instead of one *ad valorem* tax on the value of land. Two of them, Reversion Duty and Mineral Rights Duty, were not even taxes upon land values. The third, Increment Value Duty, was a charge upon only a part (usually a minor part) of the land value, levied at irregular intervals determined by death or sale. The fourth, Undeveloped Land Duty, was a small tax and subject to so many deductions and allowances that it proved difficult to collect and almost impossible for taxpayers to understand. The cost of instituting the programme of valuing land was increased unnecessarily by the cumbrous conditions laboriously spelt out in the Act, and the valuation records were never open to public inspection (in striking contrast to the valuations made for rating purposes). Harper concluded:

> ... not one of these miscalled 'land value duties' in any way resembles the

> tax on the unimproved value of land advocated by Henry George. Therefore to say—as our more unscrupulous opponents do—that the Taxation of Land Values has been tried in Britain and has failed, is not only untrue, it is the reverse of the truth!

Except for the Mineral Rights Duty, the duties imposed by Part 1 of the 1910 Act were repealed by the Finance Act 1920. The attempt to destroy land monopoly was not still-born: it had not even been conceived.

But all was not lost. The Labour Party supplanted the Liberals as the main opposition party, and they retained a strong interest in Henry George's land value tax. A socialist Chancellor, Philip Snowden, introduced proposals to tax land values in his budget in April 1931, but this was lost after the collapse of his minority government in the mid-summer crisis that led to the formation of a National Government.[19] A substantial number of Labour MPs continued actively to support the policy, but the party determined to change course. Led by Clement Atlee, Labour won a landslide victory at the general election in 1945. The opportunity for an internal reform of the free market was abandoned. Instead, the socialists now favoured an emphasis on socialist planning and the nationalisation of land, establishing the so-called mixed economy.

Was this a correct strategy for the British socialists who abandoned Henry George? Could straightforward nationalisation be successfully grafted onto the existing system? Would the 'mixed economy' secure both equity and economic efficiency? The Western socialist model has to be examined before final conclusions can be drawn on land value taxation as the only viable solution to 'the land problem' that has plagued industrial society for 200 years.

Notes

1 H.M. Hyndman, *Record of an Adventurous Life*, New York: Macmillan, 1911, p.268.

2 Cited in A.G. de Mille, *Henry George: Citizen of the World*, Chapel Hill: University of North Carolina Press, 1950, p.2.

3 Engels to A. Bebel, letter dated Jan. 18, 1884, in *Marx and Engels: Selected Correspondence,* Moscow: Progress Publishers, 1975, p.346. Lawrence described George as 'the godfather of British socialism'. E. P. Lawrence, 'Uneasy Alliance: The Reception of Henry George by British Socialists in the Eighties', *The American Journal of Economics and Sociology*, Vol. 11, No. 1, 1951, p.61.

4 K. Marx, *The Poverty of Philosophy*, Moscow: Progress Publishers, 1955, pp.134-144.

5 For a fuller treatment of the deficiencies in Marx's approach, see F. Harrison, 'Gronlund and other Marxists', in Andelson, *op. cit.*, pp.206-208.

6 K. Marx, *The First International and After*, Harmondsworth: Penguin, 1974, p. 341.
7 J. Wilczynski, *Socialist Economic Development and Reforms*, London: Macmillan, 1972, p. 37.
8 *Ibid.*, p. 185, n.2.
9 *Ibid.*, p. 184.
10 L. Colitt, 'The rare frankness of an economic chief', *Financial Times*, 10.9.80.
11 C. MacDougall and D. Housego, 'China's perplexing economic U-turn', *Financial Times*, 2.3.81.
12 Data for this part of the study of socialist land economics draws heavily on papers by, and a personal interview with, Dr. Miodrag Janić, at the World Congress on Land Policy, Cambridge, Mass., June 23-27, 1980. Opinions expressed are those of the present author.
13 M. Janić, 'The Operation of Urban Land Market in Belgrade', *Ibid.*, p. 1.
14 In 1972, about 360,000 acres of prime agricultural land were reported to be standing idle in one region alone, the Vojvodia, Yugoslavia's granary. J. Steele, 'Tito's harvest moan', *The Guardian*, 1.9.73. This would not have been possible if the tax system had socialised the full annual value of agricultural land.
15 M. Frankland, 'How to raise rents without being noticed', *The Observer*, 26.9.82.
16 Cameron Hazlehurst notes the 'fluency and remorselessness of [Churchill's] attacks on land monopoly' in his introduction to W. S. Churchill, *The People's Rights*, London: Jonathan Cape, 1970, originally published 1909.
17 Lord Douglas of Barloch, 'Land Taxation: Victim of a Vague Socialism', *Land & Liberty*, Sept.-Oct. 1980.
18 Sir E. Harper, 'The Lloyd George Finance (1909-10) Act, 1910: Its errors, and How to Correct Them', Fourth International Conference on Land-Value Taxation, Edinburgh, July 29-Aug. 4, 1929, Paper No. 11.
19 Douglas, *op. cit.*, pp. 200-208.