

4. Economic Rent: Price without Value, and the “Adam Smith Tax”

How can China keep its housing and commercial real estate affordable, so as not to raise the cost of living and doing business? To put this question another way: How can China avoid catching the American disease of rising housing prices that force new home buyers to go so deeply into mortgage debt that they have little income left to buy goods and services. The economy is shrinking from both rent deflation and debt deflation.

China and many European countries have avoided the American problem of privatized medical and health care, which absorbs 18 percent of U.S. GDP. Also avoided is the U.S. student-debt problem of having to borrow perhaps \$50,000 for each year at the university. These Financial, Insurance and Real Estate (FIRE sector) costs are largely responsible for post-industrializing the U.S. economy. So it obviously is advisable for China to continue treating banking, land ownership (including public collection of the land’s rising rental value), education and health care as public utilities. That is what has enabled it to grow so prosperous so rapidly over the past generation.

The neoliberal economics taught in Western universities cannot explain China’s success, any more than it can explain America’s industrial failure. Privatization of land rent, health care, education and other basic needs, financed by increasingly heavy debt, is viewed as the way to get rich, not poor. Rising housing and debt costs, interest charges and even monopoly rents are all counted as increasing the Gross National Product (GDP), not as economic overhead. And on the national balance sheet, *rentier* wealth – in the form of land and natural-resource ownership, monopoly privileges and creditor claims on the increasingly indebted economy – has grown much faster than wages and industrial capital investment.

Few economists or policy makers seem aware that this anti-government privatization of *rentier* wealth and income reverses the ideology that marked the emergence of industrial capitalism. No classical economist imagined that the way to get rich would be to borrow to buy real estate, whose price would be inflated by bank credit. They expected the land's rent to become the tax base, not the financial system's major form of collateral. Governments even un-taxed land and its rent, so as to increase real-estate prices, with the rental value paid to the banks as interest for larger and larger mortgage loans. This is the policy of finance capitalism, not industrial capitalism.

Britain, France and other Western nations spent most of the 19th century in a long political fight to break the power of the hereditary landlord class surviving from feudalism, whose warlords had conquered European lands and those of the Americas. By World War I the landlord class's stranglehold on political power (via the House of Lords in Britain and similar upper houses in other national parliaments) was ended. Housing and land ownership began to be democratized – on credit.

At first, this seemed to be a good thing. After World War II ended in 1945, borrowing to buy a home of one's own home ownership became the major criterion for being a member of the middle class. Home ownership became by far the major asset for most families, raising their net worth as housing prices were inflated – mainly the price of land sites with their rising rent-of-location. Bank profits also soared, as about 80 percent of bank loans in the United States were for real estate mortgages. So the financial and real estate sectors rose together, especially from 1980 onward. Absentee landlords got rich quickly as real estate was financialized. Home ownership rates rose to over two-thirds of the U.S. population and over 80 percent in much of Europe by the early 2000s.

It was mainly a white middle class in the United States. Banks would not write mortgagees for black people, and the U.S. Government housing authority would not guarantee or buy their loans. Black neighborhoods were red-lined and denied the civic services and good schools that were raising land and housing prices in the rest of America. City centers were gutted, spurring “white flight” to the suburbs. That left New York City near bankruptcy in 1974. But beginning in the 1980s, inner cities began to be torn down and gentrified, creating a new wave of debt-financed housing-price inflation.

Nearly everyone in the 1940s and 1950s could borrow to buy a home with a 30-year self-amortizing mortgage. Bank lending was limited to sums that would not absorb more than 25 percent of the debtor’s income. By the end of 30 years the mortgage would be paid off, leaving the owner’s home free and clear of debt.

It took less than 30 years for this middle-class dream to turn into a financial nightmare. What inflated housing prices from 1980 onward was bank lending – on more highly debt-leveraged terms. Banks became wealthy by recycling the exponential growth of savings into loans against almost every asset, from homes and office buildings to entire corporate buyouts. The economy was being turned into a vast Ponzi scheme, needing new buyers with new credit to keep bidding up prices by enough to pay the interest charges by borrowing against the land-price gains being inflated.

Real estate prices are bid up as banks lend more. A property is worth whatever banks are willing to lend against it. The U.S. Federal Housing Authority and its mortgage financing agencies helped banks “create homeowner wealth” by guaranteeing mortgages whose permissible debt service has risen to absorb up to 43 percent of the borrower’s income.

Having to pay these housing costs – along with other debts, pension insurance (Social Security), health insurance (Medicare) and other taxes – leaves less remaining to spend on goods and services. The economy shrinks – except for billionaires in the One Percent, whose wealth comes from owning banks, bonds, stocks and other financial assets that extract debt service and other *rentier* income from the economy's 99 Percent.

This expanding financial layer wrapped around the production-and-consumption “real” economy is an inherent dynamic of finance capitalism and its symbiosis with the Finance, Insurance and Real Estate sector. Having to pay this FIRE sector for basic needs prices labor and industry in financialized *rentier* economies out of world markets.

This Lecture 4 and its sequel Lecture 5 will explain this de-industrialization threat. U.S.-style rent and debt deflation should serve as a warning to China to avoid having its rising rental values enrich a billionaire class of absentee landlords and their bankers.

Housing prices and rental values will indeed rise as China grows more prosperous. That is natural as income becomes more widely distributed and cities build more infrastructure, parks, transportation and other urban amenities. But housing prices should not be bid up on credit, except to reflect the intrinsic cost-value embodied in buildings and other capital improvements. Taxing the rising rental value of land will save it from being pledged to banks for loans and paid out as interest. And I should make it clear at the outset that what home buyers or renters have to pay in higher land taxes will be more than offset by freeing them from having to pay income taxes and other taxes.

Classical economists sought to prevent a *rentier* class taking the land's site value for itself. Their solution was make this rental value the natural tax base, because it was better to tax it for the public than to leave it in the hands of a landlord-and-banking class.

For Adam Smith, David Ricardo, John Stuart Mill and their contemporaries, the best tax system would avoid burdening labor and industry with income taxes, sales taxes and other taxes that increased the cost of living. Taxing earned income forces up the wages that industrial employers need to pay. But taxes on land, natural resources and monopoly rights are sufficient to defray the costs of government. These taxes do not raise the cost of living or doing business, because rents that are taxed do not any cost of production. The land is simply “there,” regardless of how much is (or is not) paid for it. Landlords do not provide any productive service, but merely own the economy’s major choke point.

The virtue of a land tax is that it does not leave the rental value of good sites available to be paid to bankers as mortgage-debt service. That keeps the market price of housing down. The after-tax rent-of-location would leave only enough rent to pay lenders for the cost-value of the building. So prices will not be inflated on debt-leveraged credit. That is a precondition for China to remain a low-cost economy – without a predatory landlord class and the financial class that stands behind it.

A political struggle has been waged for five thousand years over whether government or private individuals will get the land’s “free” rent. Absentee landlords and private creditors have always tried to pry the land’s rent away from public authorities. To put this fight in perspective to show how it has shaped the evolution of land tenure over time, I will start by explaining how land tenure came into being in the first place.

Creating land tenure in proportion to its tax-paying ability – its fiscal rent

By the 4th millennium BC, Near Eastern communities had begun to schedule and assign their public corvée labor needs for basic infrastructure – building city walls, temple and palace buildings, and digging irrigation systems – and service in the military.

To organize this labor, land lots were assigned to the community's members, based on their responsibility to perform basic *corvée* and military duties.¹ Land was valued in terms of the labor or crop obligations that a given plot would support.

These labor duties were the original tax-in-kind. It was these taxes, originally in labor, that created land tenure rights assigned by the community for land and its crops, to feed and support labor in performance of its duties building public works in Mesopotamia and Egypt. These were the great socializing process of their day, with workers being fed large amounts of beer, and also meat at the festivals held during such work periods.

At some point in history, cultivators were able to commute their labor obligations and military service by paying with their land's crop as a proto-monetary payment, whose value was calculated as being equivalent to that of the labor or crops that were owed. A similar commutation occurred in medieval Europe, leading to the monetization of taxes.

Labor was the scarce resource in all early societies, including military duty in a world under almost constant threat of attack. But personal liberty began to be disrupted by the third millennium BC as interest-bearing debt emerged, owed to well-to-do merchants and members of the palace bureaucracy. They provided the sums owed to the palace that cultivators needed to cover, or simply needed to pay for rites of passage or other personal reasons. The main object of these creditors was to take interest in the form of labor to work off debts, or for the debtor to pay back the tax arrears or loans in crops. In time, creditors foreclosed on the self-support land debtors pledged as collateral.

¹ For more details see my article, "How the Organization of Labor Shaped Civilization's Takeoff," in Piotr Steinkeller and Michael Hudson, eds., *Labor in the Ancient World* (Dresden, 2015), pp. 649-664. The land was not simply grabbed by individuals who monopolized it and made others pay rent to use it. Any such archaic community who permitted this would have quickly lost its members. The idea of land tenure, crop yields, necessary remuneration for labor, and even a public administrative bureaucracy and customary law had to be developed first, in contrast to "Austrian" or other individualistic speculations.

The past five thousand years have seen a long conflict between creditors and the public sector over who should have priority in receiving this rent. Down through the modern world, the land's rent has been shifting away from paying taxes to paying interest. Yet for thousands of years throughout the early Near East, civic authority had priority, not creditor claims. New rulers taking the throne normally annulled the personal debts of cultivators, liberating bondservants and returning to the debtor's family the slaves or land that had been pledged to creditors.²

These royal acts re-asserted the ruler's power to claim corvée labor, military service and crop taxes. By restoring the "normal" distribution of land and personal liberty, that made their loss and forfeiture only temporary. But classical Greece and Rome did not inherit this practice. Few city-states had kings, and most were ruled by the large landowning families. Where kings survived, as in Rome, they were overthrown by oligarchies that accumulated the land of smallholders by lending and foreclosing, or simply grabbed it by force, and also ended up monopolizing most conquered land. The leading Senate families wrote pro-creditor laws to entrench their power, and this spirit of the law survived the collapse of Rome's Empire to serve as the basis for Western law ever since.

The main legacy from European feudalism was a hereditary landlord class. After the Norman invasion of England in 1066, William the Conqueror ordered compilation of the Domesday Book to calculate how much rent could be extracted from English land, and appointed his companions to administer it. A century later, when King John (1199-

² Such royal amnesties are documented down through the early 1st millennium BC. I document these royal proclamations in ... *and forgive them their debts: Credit and Redemption From Bronze Age Finance to the Jubilee Year* (Dresden 2018). See also Michael Hudson and Marc Van De Mieroop, eds., *Debt and Economic Renewal in the Ancient Near East* (Bethesda, 2002).

1216) abused his power, the land barons led a revolt and forced him to sign the Magna Carta in 1215. That went a long way toward privatizing control of the land's rent.

Similar privatization of rents by absentee owners occurred throughout Europe. A constant struggle simmered between lords and the kings over how to share the land's rental surplus. Kings spent most of their taxes on wars to conquer foreign rent-yielding land. That left little revenue to alleviate poverty or invest in industrial capital formation. The silver and booty seized from the New World by Spain and Portugal flowed right through them to other countries, not find productive investment opportunities at home.

The "Adam Smith Tax" on land rent as the focal point of classical value and price theory

French taxes and rents were so high that domestic industry could not compete with that of Britain or other European countries. A group of reformers clustered around the royal surgeon, Dr. Francois Quesnay, who created the first major statistical accounting format, the *Tableau Économique* (1758), to trace the circulation of income within the French economy. Calling themselves the Physiocrats or *Les Économistes*, they traced how the landlord class and royal estate appropriated almost all of France's economic surplus as land rent – the *produit net* (net product).

In order for France to industrialize and become more affluent, the Physiocrats argued, it had to break free from its *rentier* overhead. Among the visitors to France was Adam Smith, whose economic views were strongly influenced by his meetings with them. Returning to Scotland, he adopted their major reform proposal: Taxes should fall on the land, not on labor or industrial capital, which were the source of prosperity. Private ownership of the land was a chokepoint to extract the value of its crop surplus over and above the cultivator's living costs and the expenses necessary to produce his

crops. “Landlords love to reap where they have not sown,” Smith wrote in *The Wealth of Nations* (1776), “and demand a rent even for its (the land’s) natural produce.”

Driving home the point, he added: “The dearness of house-rent in London arises ... above all the dearness of groundrent, every landlord acting the part of a monopolist.”³

Ricardo’s theory of differential land rent in Britain’s debate over the Corn Laws

Taxing land rent was politically difficult to achieve, because the landlord class controlled the upper houses of parliaments throughout Europe. It began to be challenged in the wake of the 1789 French Revolution, which led to Napoleon’s wars to spread liberal reforms. His war with Britain started in 1798 and continued until 1815, imposing a naval blockade that disrupted Britain’s seaborne commerce.

Unable to import much food, Britain was forced to fall back on its domestic farming sector. Crop prices rose to reflect the more limited and high-cost supply. Upon the return to peace in 1815, British landlords persuaded Parliament to impose tariffs on food imports – the Corn Laws – to artificially maintain high domestic crop prices, and hence the high agricultural rents they had enjoyed during the years of wartime isolation.

The ensuing fight over the Corn Laws (which finally were repealed in 1846) became the occasion for a landmark debate between Thomas Robert Malthus (most famous for his population theory) arguing on behalf of Britain’s landlords, and David Ricardo, the parliamentary spokesman for the nation’s banking class. Although industry was not yet a major bank client, the major bank market lay in financing foreign trade. So

³ Adam Smith, *Wealth of Nations*, Book I, Ch. 6 §8, and Ch. 10, §55. Smith added that landownership privileges “are founded on the most absurd of all suppositions, the supposition that every successive generation of men has not an equal right to the earth ... but that the property of the present generation should be ... regulated according to the fancy of those who died ... five hundred years ago,” that is, the Norman conquerors (Book III, Ch. 2, §6). Anti-classical writers call this the Henry George tax, mainly to avoid having to deal with the classical value and price theory held by Smith and other classical economists.

bankers had an interest in promoting industry was to promote an international division of labor in which Britain would be the “workshop of the world,” exporting manufactures in exchange for foreign raw materials and handicrafts.⁴

At the center of this debate was the concept of economic rent that Ricardo refined as part of his free-trade argument against protective tariffs. The aim was not yet to tax away the landlord’s rent, much less to nationalize the land. That fight would become prominent only in the second half of the 19th century. It was the Corn Laws debate that helped define classical value and rent theory in the process of explaining how Britain might become “the workshop of the world.”

To do so, British manufacturers needed a cost advantage against foreign rivals. That required minimizing the wages that employers had to pay, so the first objective was to minimize the basic wage, determined by the cost of living, headed by the price of food.

This logic set the economic needs and political dynamic of industrial capitalism against Britain’s post-feudal *rentier* aristocracy. Minimizing the cost of feeding wage earners required obtaining low-priced food. That required repealing the protectionist Corn Laws so as to buy much less expensive grain from the United States, Latin America and other less industrialized countries.

That was precisely what Britain’s landlord class opposed, prompting Ricardo to write in 1815, soon after the Treaty of Ghent restored peace: “The interest of the landlords is always opposed to the interest of every other class in the community.”⁵

⁴ When Western economies began to recover in the 12th century (thanks largely to the monetary loot grabbed by the Crusaders), Christian law had banned usury, but permitted a loophole for banks to charge foreign-exchange *agio* fees for the service of transferring payments from one country or currency to another. The banking interest therefore was to increase international trade and its specialization of production between industrial Britain and countries providing its industrialists with raw materials.

⁵ Ricardo, *Essay on the Influence of a Low Price of Corn on the Profits of Stock* (London: 1815): 21.

For Ricardo, “the community” meant mainly his own banking class and the industrialists that he hoped would produce exports, not the wage-earning class, whose wages Ricardo assumed would tend to remain at the subsistence level in any event.

Ricardo spent the next two years writing *On the Principles of Political Economy and Taxation* (1817). Chapter 2 defined economic rent in terms of the classical value and price theory. Value was based on necessary costs of production, ultimately reducible to the cost of the labor.⁶ But many products sold for higher prices, above all, the products of agriculture. Ricardo believed that crop prices would rise as a result of diminishing fertility on marginal soils, which had to be brought into cultivation as the population increased. That left more “differential” rent in the hands of owners of higher-yielding land with lower costs of production. When diminishing returns resulted in prices being set by the highest-cost producers, the marginal price was often far above the costs to owners of more productive land. The excess of market price over and above actual costs to these low-cost producers was called “differential economic rent.”

Ignoring the role of fertilizer, Ricardo thought that the land’s fertility differentials were permanent, persisting even after land was improved.⁷ Each plot of land was held to receive a distinct income in accordance with its permanent fertility differential. He imagined that the poorest and most marginal land would not produce any rent at all. For him, there was only differential rent, not absolute monopoly rent. By contrast, James

⁶ Numerous writers already had described the basic elements of this theory. Their writings are reviewed in Marx’s *Theories of Surplus Value*, Vol. II (Moscow: 1968), compiled posthumously by Karl Kautsky from Marx’s notes. The three volumes of that work explain how Marx came to refine his labor theory of value as an outgrowth of classical rent and exploitation theory, and thus are complementary to Marx’s *Capital*.

⁷ Ricardo, *Principles*, 3rd ed. (London: 1821), p. 67. He added (pp. 412-13): “Improvements in agriculture ... increase the quantity of raw produce obtained from each [plot], but probably do not disturb the relative proportions which before existed between the “original and indestructible powers of the soil.”

Andersen and David Buchanan saw that “absolute” monopoly rent existed over and above the differential rent that Ricardo described.⁸ Buchanan recognized the existence of monopoly rent as well as differential rent, although he believed that the major cost differences stemmed from capital productivity and transport costs.

Heinrich von Thünen emphasized the latter, replacing Ricardo’s idea of fertility differentials with the rent of location. In *The Isolated State with Respect to Agriculture and Political Economy* (1826), he created the formula $R = Y(p - c) - Yfm$. Land rent (R) was the sum of the market price (p) of its yield per unit (Y), less the cost of production (c), and less the transport costs, which were determined by the freight rate per crop per mile (f), multiplied by the distance over which the crop had to be transported to market (m).

Adam Smith had recognized the rent of location: “The corn which grows within a mile of the town, sells for the same price with that which comes from twenty miles distant,” but the latter must bear the costs of shipping the crop to the urban market.⁹ Rent of location thus was not earned; it was supplied by geography, being increased as the economy’s overall demand and prosperity increased. If crops had to be brought from further away, their supply price rose, with the “rentless land” being the most distant.

By the end of the 19th century the rent of location was recognized as resulting not only from transport costs but also from public amenities (parks, schools and museums), urban improvements and the special desirability of certain neighborhoods (either from prestige or avoidance). But the major rent of location has indeed reflected transportation.

⁸ Ricardo, *Principles*, 3rd ed., (London: 1821), p. 71. Adam Smith (above) had referred to land as a monopoly, and David Buchanan, *Observations on the Subjects Treated of in Dr. Smith’s Wealth of Nations* (Edinburgh 1817), pp. 34 and 37. Joan Robinson, *The Accumulation of Capital* (London: 1956), pp. 289-293. emphasized rent as a monopoly “good,” reflecting the fact that all land is scarce. That point was made also by Thomas Perronet Thompson, *The True Theory of Rent, in Opposition to Mr. Ricardo* (1826), p. 6.

⁹ Smith, *Wealth of Nations*, Book III, chapter 1.

The rental value of land is enough to cover public expenses for basic needs.

London spent £3.4 billion to extend the Jubilee tube line to the Canary Wharf financial district. The effect was to raise the valuation of land along the route by over £10 billion. The entire cost of this public construction could have been defrayed by taxing the land's increased rent-of-location – an unearned free lunch. Instead, London taxed wage earnings and profits. So taxpayers bore the cost, while “land owners contributed nothing towards the increased value that accrued to their assets.”¹⁰

A similar rent-of-location giveaway occurred when New York City built its Second Avenue Subway for about \$3 billion. Rents and property prices rose along the new route by a reported \$6 billion, because people no longer had to walk a mile to the overcrowded Lexington Subway. That increase in rental valuation was much more than enough to cover what it cost the city to build the system. The cost could have been met by imposing a “rent recapture” tax on the real estate whose market prices rose. Instead, the city borrowed and paid interest to bondholders, and increased income taxes on labor and business. That made the city's cost of living and doing business higher – by the amount that landlords and bondholders received.

Bus and subway lines, streets and highways all affect real estate's site value. Thorstein Veblen described urban politics as being concerned mainly with civic improvements projects to promote real estate by land speculators. That has been the essence of urban American politics. The aim of public infrastructure spending is indeed to increase land prices. Real estate developers try to keep all the land-price gains for themselves, making the public pay.

¹⁰ See Fred Harrison, *Ricardo's Law* (London: 2006), p. 83, and Don Riley, *Taken for a Ride: Trains, Taxpayers and the Treasury* (London 2001).

Most land-price gains stem from public infrastructure investment that makes neighborhoods more desirable. Who should get the benefit of such improvements? How should cities and municipalities pay for the cost of improving the means of transportation and other neighborhood amenities?

What seems most fair is to finance such improvements by taxing back the increased rental value of the land sites. Otherwise, existing landlords will receive free rental value at public expense. The result of *not* taxing this rise in rents is to channel an increasing proportion of income to landlords. That income is extracted at the expense of wages and profits, as Ricardo explained.

Rent deflation as industrial capitalism's Armageddon

Ricardo opposed letting land rents increase, because that would raise the cost of living and hence employment of industrial labor. Rent would crowd out profits. "The natural tendency of profits then is to fall; for, in the progress of society and wealth, the additional quantity of food required is obtained by the sacrifice of more and more labor."¹¹ As Marx summarized Ricardo's theory, the limit on "the capital that can be applied with a profit would be reached at the point where food prices (and the associated wage levels) were so high that the employment of industrial labor no longer could provide the industrialist with a profit. The economy and its population at that point would reach its upper limit, and new capital investment and employment would stop."

That process could be postponed temporarily, Ricardo acknowledged,

by the improvements in machinery, connected with the production of necessaries, as well as by discoveries in the science of agriculture which enable us to relinquish a portion of labour before required, and therefore to lower the price of the prime

¹¹ Ricardo, *Principles of Political Economy and Taxation*, Ch. 6: "On Profits," (3rd ed., London 1821), pp. 120f., cited in Marx, *Theories of Surplus Value*, Vol. II, p. 544.

necessary of the labourer. The rise in the price of necessaries and in the wages of labour is however limited; for as soon as wages should be equal ... to ... the whole receipts of the farmer, there must be an end of accumulation; for no capital can then yield any profit whatever, and no additional labour can be demanded, and consequently population will have reached its highest point. Long indeed before this period the very low rate of profits will have arrested all accumulation, and almost the whole produce of the country, after paying the labourers, will be the property of the owners of land and the receivers of tithes and taxes.¹²

“This, as Ricardo sees it,” summarized Marx, “is the bourgeois ‘Twilight of the Gods’ – the Day of Judgement.” Ricardo warned that rising land rent was the great threat to industrial capitalism’s survival. Despite the increase in technological productivity and wealth, real estate and other natural resources (and implicitly, natural monopolies) would concentrate a rising proportion of income in the hands of *rentiers*, whose rent (R) was unearned. That is the central message of classical value and rent theory. Rent (R) is the excess of Price (P) over Value (V), so $R = P - V$. As the excess of market price (P) over intrinsic cost-value (V), rent has no counterpart in necessary costs of production. Rent recipients have no out-of-pocket costs for supplying landlordship or monopoly “services” for what basically are transfer payments – income with no socially necessary *quid pro quo*.

All economic rent is by definition unearned, to the extent that it is not based on necessary costs of production – land rent, natural recourse rent and monopoly rent. Land has no cost of production, any more than air or mineral wealth in the ground – or monopoly rights, for that matter. In industry, Alfred Marshall (whose 1890 *Principles of Economics* was the dominant economic textbook in England for many years) described quasi-rents as

¹² *Principles*, 3rd ed., p. 123. Ricardo adds: “Long before this state of prices was becoming permanent, there would be no motive for accumulation; for no one accumulates but with a view to make his accumulation productive, and ... consequently such a state of prices never could take place. The farmer and manufacturer can no more live without profit, than the laborer without wages. Their motive for accumulation will diminish with every diminution of profit, and will cease altogether when their profits are so low as not to afford them an adequate compensation for their trouble, and the risk which they must necessarily encounter in employing their capital productively.”

accruing to innovative producers with lower costs of production, under conditions where market demand enables prices to be set by the older higher-cost producers.

Farming in today's world has become so industrialized and treated with fertilizers that Ricardo's theory of differential rent has become one of the least significant areas of rent seeking. There is substantial monopoly rent in the case of the great grain-trading monopolies such as Cargill and Archer-Daniels, and seed bioengineering from Monsanto. But the rent of location is now minimal for agriculture, as canning companies and stockyards have moved closer to production sites. What remains is the concept of economic rent generalized beyond land to the Finance, Insurance and Real Estate sector and monopolies (communications and the broadcasting spectrum, transportation and other infrastructure).

The political fight to tax land, from John Stuart Mill to subsequent land taxers

Ricardo argued that the way for a nation's manufacturers to win the competition for foreign markets profits was to cut costs, starting with the living wage that employers had to pay to cover, headed by food. The way to minimize this labor cost was to minimize land rent. To Ricardo that meant free trade. But to , British reformers after the trade issue had been settled by repeal of the Corn Laws in 1846, it meant freeing economies from private land rent and, by logical extension, preventing predatory monopoly pricing by other rent-seekers.

This drive to cut *rentier* income was inherent in industrial capitalism in countries where landlords and monopolists enjoyed special privileges, as they did in Britain, whose House of Lords blocked reforms proposed by the House of Commons.

The division of government into two chambers dates back to history's earliest written records in the third millennium BC. The Sumerian epic of Gilgamesh describes

the men of military age (in Greek the *demos*, the root of *democracy*) voting on whether to go to war. Drafting laws seems to have been made by councils of elders (Rome's Senate, as in *seniors*). That kind of bicameral congress has survived down to the modern world, with the population at large struggling against *rentier* interests since classical antiquity.

Most populations had only one ultimate recourse: to refuse to fight, or, what was the same thing, to walk out, as occurred in Rome's repeated secessions of the plebs seeking debt cancellation and land redistribution during the Republic, 509-27 BC. Neither the popular assembly nor the senate had much role in the Roman Empire, and European nations after the Middle Ages saw the upper house of wealthy landowners dominate governments. That state of affairs threatened to block the emergence of industrial capitalism, which fought to free economies from rent extraction by the landed aristocracy.

To free economies from rents owed to the hereditary aristocracy and predatory banking class, "economics" became "political economy" advocating democratic parliamentary reform to replace the upper houses of parliament with the more democratic Commons. Recipients of unearned income had long been the wealthiest class in Western society, using their wealth to control government and shift the tax burden off themselves onto labor and industry. As Richard Cobden summarized in 1842

It certainly was only when the power of the state had fallen into the hands of a landed oligarchy that the people were taxed in order to exempt the landowners. At the time of the conquest, and for the succeeding 150 years, the proportion of tax contributed by the land amounted to nineteen-twentieths of the whole revenue of the kingdom. From that period down to the reign of Richard the 3rd, the proportion contributed by the land was nine-tenths; thence, to the time of Mary, it was three-fourths; to the end of the Commonwealth it was one-half; to the time of Anne one-fourth; in the time of George 1st one-fifth; of George 2nd one-sixth; for the first thirty years of George 3rd one-seventh; from 1793 to 1816 one-ninth; and from that time to the present only one-twenty-fifth.

The land-tax was a fraudulent evasion, for it was in reality a substitution for feudal tenure. The land was formerly held by right of feudal services. The

honourable gentleman quoted a passage from Blackstone, describing the commutation of feudal services into a land-tax of 4 shillings in the pound on the real rental. Now could anyone suppose that land would always remain at the valuation of 1692? And yet it was upon that valuation that the land-tax was charged.¹³

Throughout Europe the aristocratic upper house blocked reforms to protect landlords and other *rentiers* against democratic reformers seeking to shift policy-making power to the lower house, representing the population at large. A radical reform was necessary for social democrats to tax away land rent. It required freeing the Commons from veto by the *rentier* upper house.

There are two ways to prevent rent extraction from impoverishing industrial economies. The least revolutionary was Ricardo's proposal to enact free trade to buy lower-priced food abroad. After the Corn Laws were repealed, John Stuart Mill and other liberals sought to make land rent the tax base. The more radical way was to nationalize the land outright. Mines and other natural resources had long belonged to the public sector, and also natural infrastructure monopolies. Socialists aimed to make the land and basic infrastructure part of the public domain (the Commons).

By the end of the 19th century the concept of land rent as unearned income (and hence, as the appropriate tax base) was extended to monopoly rent as well. It was to prevent monopolies and their rent-seeking that basic needs and infrastructure were kept in the public domain instead of being privatized. The monopolies to be turned into public utilities began with basic infrastructure: roads and railroads, health care, water and sewers, and communications.

13 [Richard Cobden: Corn Bill, Burdens on Land \(HC Deb 14 March 1842 Vol 61 cc519-81\)](#)

An argument briefly surfaced over whether the government should buy out the landlords so as to socialize future rent increases. Critics pointed out that paying full market price for land would monetize the economy's largest asset, converting the landlord class into an equally dominant financial class.

Something similar actually occurred. Many landlords saw the handwriting on the wall and sold their lands to invest in industry and financial markets. Landownership became democratized, on credit. Real estate mortgage lending became a more lucrative field for banking than international trade and money-changing had been. So the turn of the 20th century saw banking and real estate join hands. That alliance began to consolidate what would become the Finance, Insurance and Real Estate (FIRE) sector.

What made industrial capitalism so politically revolutionary was the political fight between opponents of land taxation (*e.g.*, Britain's House of Lords) and land taxers (supported by the House of Commons). The Progressive Era's drive to make economies more competitive entailed a political fight against the vested post-feudal landlord class, by promoting democratic reform. In Britain that fight culminated in the 1909-10 constitutional crisis when the House of Lords rejected a land-tax bill that the Commons had passed. Matters were resolved by ruling that the House of Lords never again could veto a revenue act passed by the Commons.

By the early 20th century an alliance of industrial capitalism and commerce had gained sufficient power to challenge the landlord class by backing democratic political reform. Opponents of the landlord aristocracy pushed the classical political economy created by France's Physiocrats, Adam Smith, David Ricardo, John Stuart Mill and their contemporaries forward to defend the interest of the commons in general.

That became the essence of Marxism. Marx elaborated the idea of rent as exploitation into a critique of the industrial capitalism's exploitation of wage-labor. Describing industrial profits as a power relationship analogous to the landlord's exploitation of renters, he applied the concept of economic rent as an exploitative charge by the monopoly power of industrial capital.

In Marx's system the aim of industrial capital remained the same as it was in Ricardo's critique of the landlord class: to minimize the cost of subsistence while selling labor's products at as high a markup as possible – the profit extracted ultimately from labor. He placed that analysis in Vol. I of *Capital*, because his predecessors already had thoroughly discussed the concepts of economic rent, compound interest and the financial system that he reviewed in Volumes II and III to explain the evolution of industrial capitalism out of earlier *rentier* societies.

Rent theory as the basic classical free market reform

A “factor of production” creating value has a cost. Labor earns wages and capital earns profits. But land and sunlight are provided “freely” by nature. The radio spectrum is like land. The air waves are simply there, provided by nature, like air. But rent-seeking opportunities can be created by levying an access charge or licensing fee, because production and broadcasting cannot take place without them. They are not manmade and hence do not require any cost of labor or other socially necessary payments to provide their rental opportunities.

Economic rent is cost-free and hence unearned income – land rent, natural recourse rent and monopoly rent, including financial privileges. Land has no cost of production, any more than air or mineral wealth in the ground – or monopoly rights, for

that matter, except for the legal costs of patent filing and campaign contributions to politicians to make the theft of the commons legal. The resulting monopoly rent is a purely extractive tollbooth charge for privilege (literally “private law”).

Land rent is payment for such a privilege. Land is a choke point, created by legal, institutional and political dynamics as distinct from the technologically necessary cost of production. That is why the economic analysis of rent in the United States passed into the hands of the Institutionists by the late 19th century.¹⁴

It is economically self-destructive for a society to try and get rich by buying housing whose market price is constantly being bid up by debt. The effect is to raise the cost of living and doing business, by adding to the debt overhead. This financialization of real estate is at the expense of the tax collector.

Summary

The U.S. and European economies have a self-destructive belief that providing more bank credit to bid up housing prices makes the economy richer. Certainly most of the net worth – that is, wealth – of the American middle class consists in its housing. The rise in U.S. housing prices has endowed a white middle class with household wealth. (But blacks in poor neighborhoods that have been redlined have been excluded. Un-taxing real estate has increased housing prices, while the tax burden has been shifted onto wages and business income. But the major factor raising housing prices has been bank credit. A property is worth as much as a bank will lend against it – and banks have lent more and more against residential and commercial properties.

¹⁴ I describe this in “Simon Patten on Public Infrastructure and Economic Rent Capture,” *American Journal of Economics and Sociology* **70** (October 2011): pp. 873-903.

It is economically self-destructive for society to try and get rich by buying housing whose market price is constantly being bid up by debt. The effect is to raise the cost of living and doing business. That is what Ricardo warned would bring industrial capitalism to an end. It is indeed how today's American finance capitalism is de-industrializing the U.S. economy.

Financializing real estate is at the expense of the tax collector. Whatever rental value the tax collector relinquishes is available to be pledged to bankers as interest. The way to prevent debt-leveraged increases in housing prices is thus simple enough: Taxing the land's rental value would replace the current guideline – “Rent is for paying interest” –in favor of Adam Smith's classical principle: “Rent is the natural tax base.”

This approach was quickly picked up in Russia and China. Sun Yat Sen (1866-1925) emphasized land taxation in equalizing land rights for the Chinese: “The teaching of Henry George will be the basis of our program of reform ... The (land tax) as the only means of supporting the government is an infinitely just, reasonable and equitably distributed tax, and on it we will found our new system. The centuries of heavy and irregular taxation for the benefit of the Manchus have shown China the injustice of any other system of taxation.”

Dr. Sun's aim was to prevent a landlord class from continuing to dominate Chinese development. His Three Principles of the People proclaimed: “The railroads, public utilities, canals, and forests should be nationalized, and all income from the land and mines should be in the hands of the State. With this money in hand, the State can therefore finance the social welfare programs.”¹⁵

¹⁵ Cited in Karl Williams, “Sun Yat Sen and Georgism,” at <https://www.prosper.org.au/geoists-in-history/sun-yat-sen-and-georgism/>, and Simei Qing, *From Allies to Enemies: Visions of Modernity*,

Qingdao, in Shandong province, adopted a 6 percent land tax under the German colonial administrator and land reformer Wilhelm Schrameier after German troops seized the city after 1897 (and introduced their beer-making practices to found Tsingtao Brewery). Dr. Sun visited the city in 1912 and called its land tax a model for China's future.

Hong Kong is the best-known Chinese city financing its public budget by taxing the land, at least in the sense that it has based its civic revenue on a land tax. But it has not collected all the land rent by any means. That is why there are so many real estate billionaires in Hong Kong. Its policy falls short of what 19th-century land and tax reformers urged.

China today has become the workshop of the world, largely by avoiding the *rentier* class responsible for de-industrializing the U.S. and other Western economies. The government is nominal owner of the land. The question is, will it tax the full site value of this land? Housing prices are rising not because of population growth, but because of rising prosperity coupled with rising public infrastructure investment. If China does not tax the full rising rent-of-location, this rent will end up being paid to the banks as interest, as occurs in the United States.

Throughout today's world banks are replacing landlords as the ultimate recipients of land rent. The debt-financed rise in the cost of housing increases the cost of living for China's wage-earners. That undercuts their competitiveness and slows

Identity and U.S.-China Diplomacy, 1945-1960, (Cambridge, MA: 2007), p. 19. See also Michael Silagi, "Land Reform in Kiaochow, China: From 1898 to 1914 the Menace of Disastrous Land Speculation was Averted by Taxation," *American Journal of Economics and Sociology* 43 (1984), pp. 167-177.

economic growth. That is the American disease: Land rent and other forms of economic rent are paid to the *rentier* class that has become society's top One Percent.

Transition to Lecture 5

As the role of agriculture has shrunk to only 3 percent of GDP in the United States, the main form of land rent occurs in urban real estate. Land is now widely owned – on credit, with rent paid as interest to the banking and financial class, not landlords. Reducing taxes on real estate raises land prices, by the extent to which the increased rents are capitalized into bank loans, with most rental income ends up being paid as mortgage interest. Whereas Ricardo envisioned landlords as monopolizing society's income, the democratization of land ownership has led new buyers to become indebted to their bankers.

Debt deflation now plays the role that rent deflation played in Ricardo's analysis. Pointing to an allegedly physical cause, diminishing soil fertility, as increasing costs at the expense of industrial profits, Ricardo did not acknowledge interest and financial fees as adding to the cost of living, and even denied that paying debts could deflate markets. His international economic theory insisted that creditors would spend their income back into the economy.

Financialized economies have painted themselves into a corner in which the rent has been pledged to banks for the credit needed to buy homes and commercial properties and other rent-yielding assets. Taxing away this economic rent would crash today's over-indebted financial system, because rental income has become the primary collateral base on which today's finance-capitalism rests.

Suggestions to slowly tax away the land rent that are unlikely to work, because of the strong political power that landlords have gained, backed by their bank sponsors. The banking system's monopoly of credit creation is the crowning privatization of what

industrial capitalism and socialism expected to become a public utility. The resulting debt deflation is the topic of the next lecture. The most practical solution was to minimize the price of land by taxing away its groundrent, leaving none to be capitalized into bank loans to bid up market prices.

For Discussion:

Note Chile's failure of land reform. Allende claimed to be a Marxist, but ignored the rural land issue. Chile had the lowest agricultural productivity in its region, yet had the world's largest endowment of natural fertilizer – guano (bird droppings), its major export after copper and its associated metals. But Chile's land tenure based on enormous latifundia and small family microfundia prevented agricultural modernization. This was a major reason why Allende's "socialist" victory gained so little backing, enabling the army to take over with so little resistance. Marxism Chilean-style was an urban middle-class phenomenon, excluding the landed peasantry, the indigenous population, and industrial labor. It was effete elitism.

By the end of the 19th century, this concept of land rent as unearned income (and hence, as the appropriate tax base) was extended to monopoly rent as well. It was to prevent monopolies and their rent-seeking that basic needs and infrastructure were kept in the public domain instead of being privatized.

How are we going to think about economics? Henry George used a "desert island" approach popular with individualists. Suppose one person finds an island, like Robinson Crusoe – and then says, "I own this land." Anyone newcomer will have to pay him rent (if he has a police force to enforce his ownership claim).

But civilization and its land tenure did not begin on desert islands. It began with communities settling down, and having to mobilize their labor and hold the loyalty of their members so that they would not defect, flee or overthrow their chieftains. There had to be a form of land tenure that was voluntary – by giving everyone self-support land.

Individualists prefer heuristic examples single individuals by themselves, without any social context. I think that history is necessary, which is why I began by explaining why land tenure was organized as part of the fiscal system in the late Neolithic.

