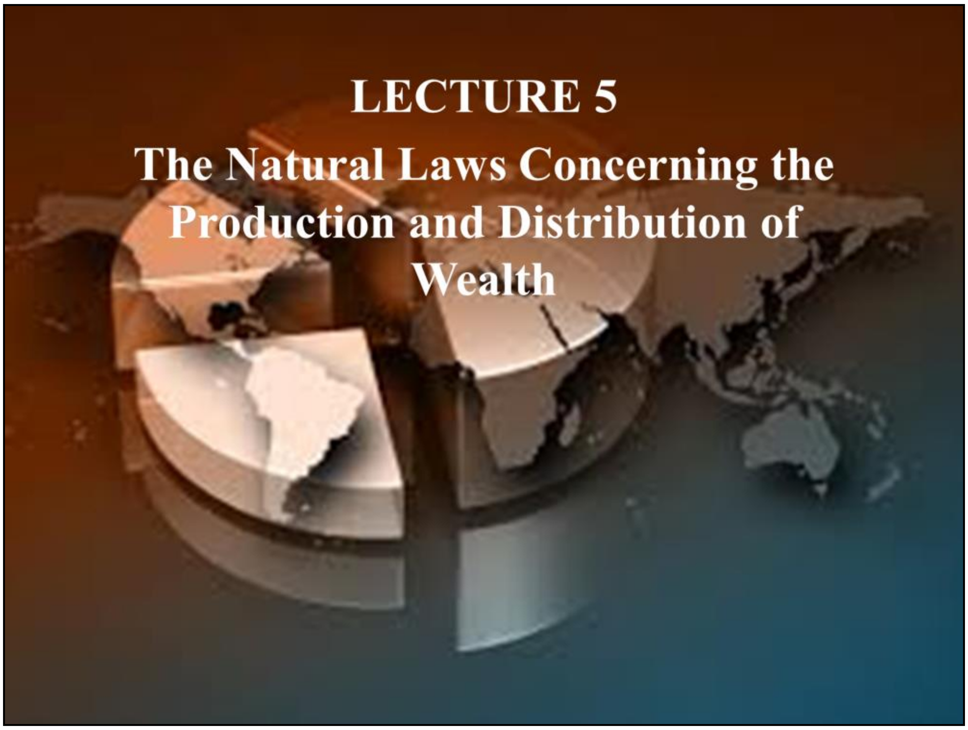
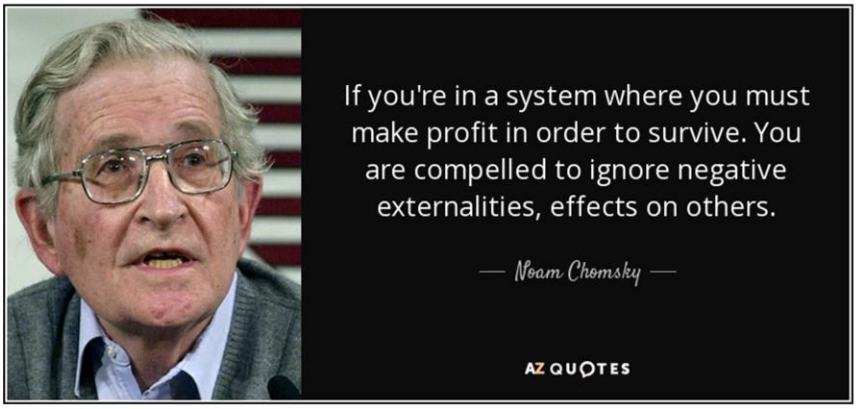

Understanding our Political Economy


LECTURE 5
The Natural Laws Concerning the Production and Distribution of Wealth

Henry George brought his analytical skills to the challenge of explaining the processes by which wealth is produced and then distributed back to the factors of production – rent to land, wages to labor and interest to capital goods.

These processes were, he concluded, governed by natural laws of tendency that flow from consistent human behavior. They operated as tendencies because there is a wide range of what in economics are called “externalities,” including the very powerful externalities of government and law.



And, as Noam Chomsky reminds us: "If you're in a system where you must make a profit in order to survive, you are compelled to ignore negative externalities, effects on others."

The extent to which one can, in fact, ignore such negative effects on others is a measure of the extent to which a society's laws, its socio-political arrangements and institutions are just.

It was David Ricardo who made the first attempt to apply scientific observation to how land is chosen for development. Ricardo's focus was on agriculture and the differences in natural fertility:

“After all the fertile land in the immediate neighbourhood of the first settlers were cultivated, if capital and population increased, more food would be required, and it could only be procured from land not so advantageously situated.”

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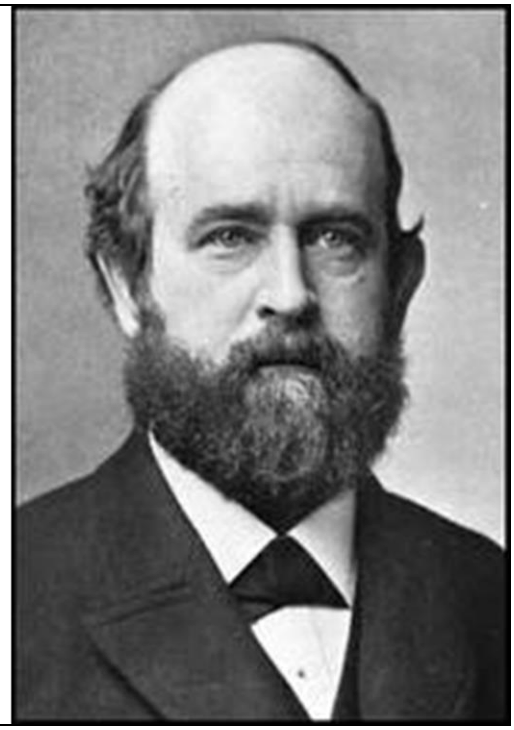
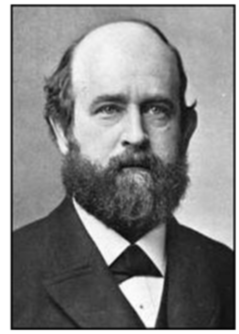
Henry George



Henry George extended Ricardo’s analysis well beyond a treatment of agricultural land and applied it to locations in cities and towns and to all that George came to describe as natural monopolies. The definition of rent Henry George came to is as follows:

“Rent is that portion of production (or, wealth) claimed in return for access to land, when land of equal quality is no longer freely available. …”



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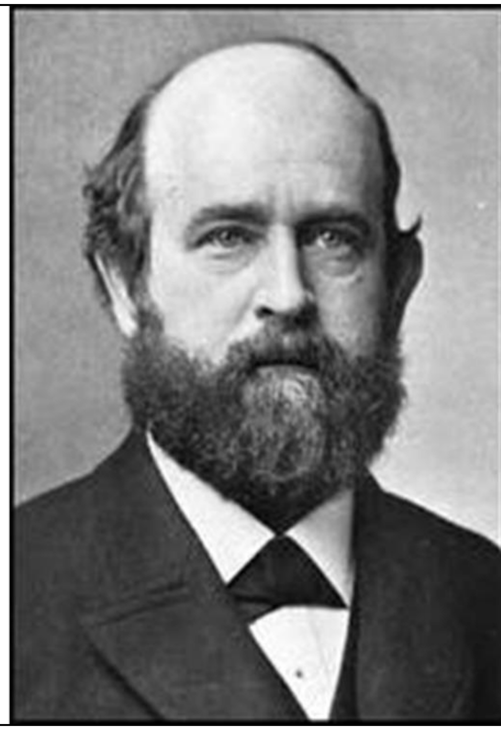
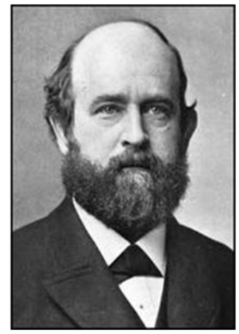


George went further, introducing to readers the concept of the "margin of production."

“Rent is determined by the margin of production. That is, rent equals the amount of produce in excess of what could be produced from the poorest land in use with the same amount of labor and capital.”



***Progress and Poverty*, p.86**

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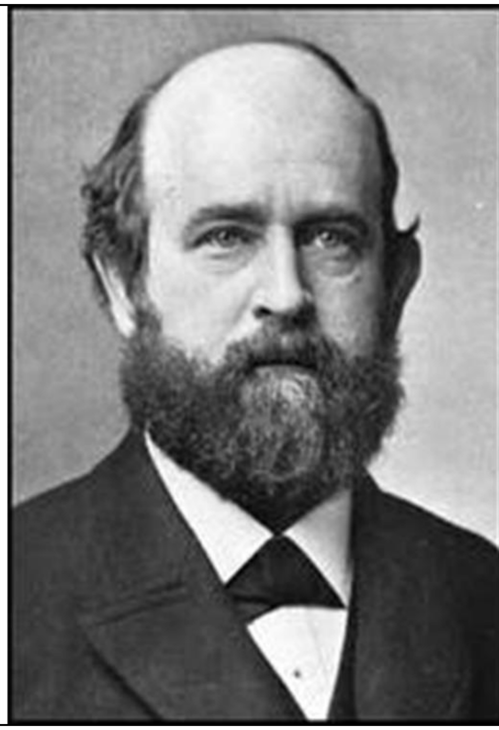


Note that Henry George's definition is descriptive here. He will later in his analysis add moral judgments with regard to laws and policies by which rent is redirected from a community or society to private individuals and entities.

Returning to the theoretically ideal community we earlier established, we can take a scientific look at what happens to the initial relative level of equality of opportunity existing in the early period of settlement.

Subsistence requires 60 units of wealth

Commercial land now yields 300 units of wealth

Assume that a subsistence living requires 60 units of wealth. A generation after the city is established, the same size land parcel – now used for commerce rather than agriculture -- yields 300 units of wealth, now acquired by exchange of goods and services. There is no longer any land in the city that can be settled on for free. Let’s look at this process using some simple graphs.

Rent Graphically Illustrated

50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100

Best land yielding 100 units of wealth

Returning again to the earliest stage of settlement. When all land initially is freely accessible, the best locations will potentially yield 100 units of wealth. The entire yield is *wages* (the return to labor) and *interest* (the return to capital goods) in some proportion, determined by the productivity of labor and the quality of the capital goods available.

LAND STILL NOT FULLY OCCUPIED AND FREELY AVAILABLE / NOW FULL

50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100

	0	0	0	0	**10**

RENT'S CLAIM ON WEALTH

When land yielding 100 units of wealth is fully occupied, the next best locations still freely accessible yield 90 units of wealth. Again, with the same input of labor and capital goods. Now, the best locations command *rent* of 10 units. Political economy describes the best freely accessible land as the "margin of production."

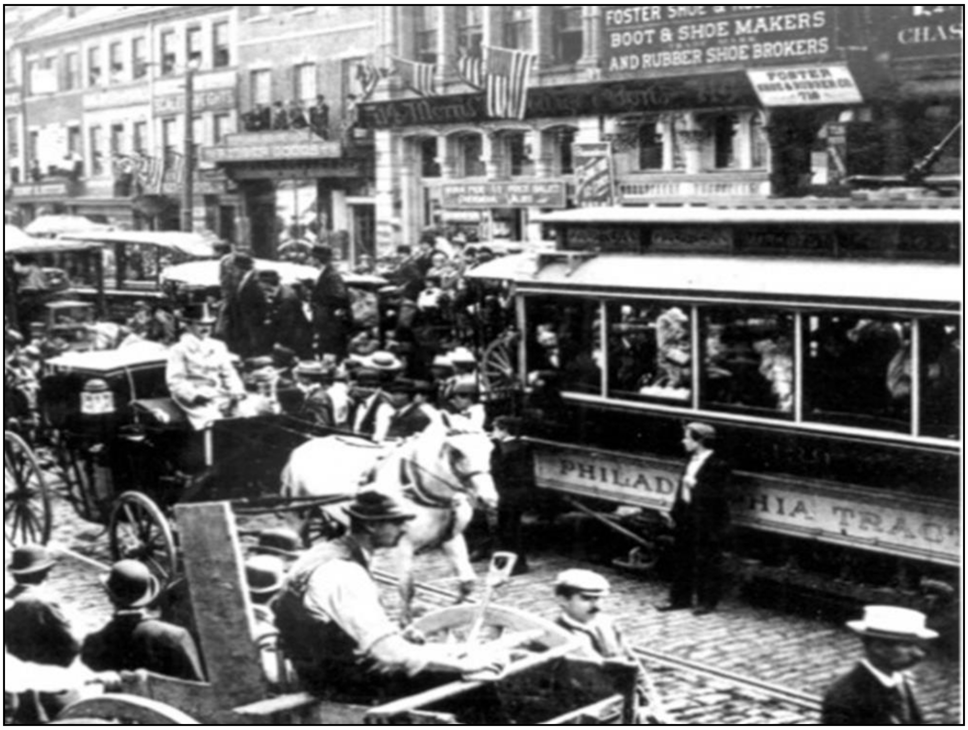
STILL FREE / NOW FULLY OCCUPIED AND YIELDING RENT

50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100
50	60	70	80	90	100

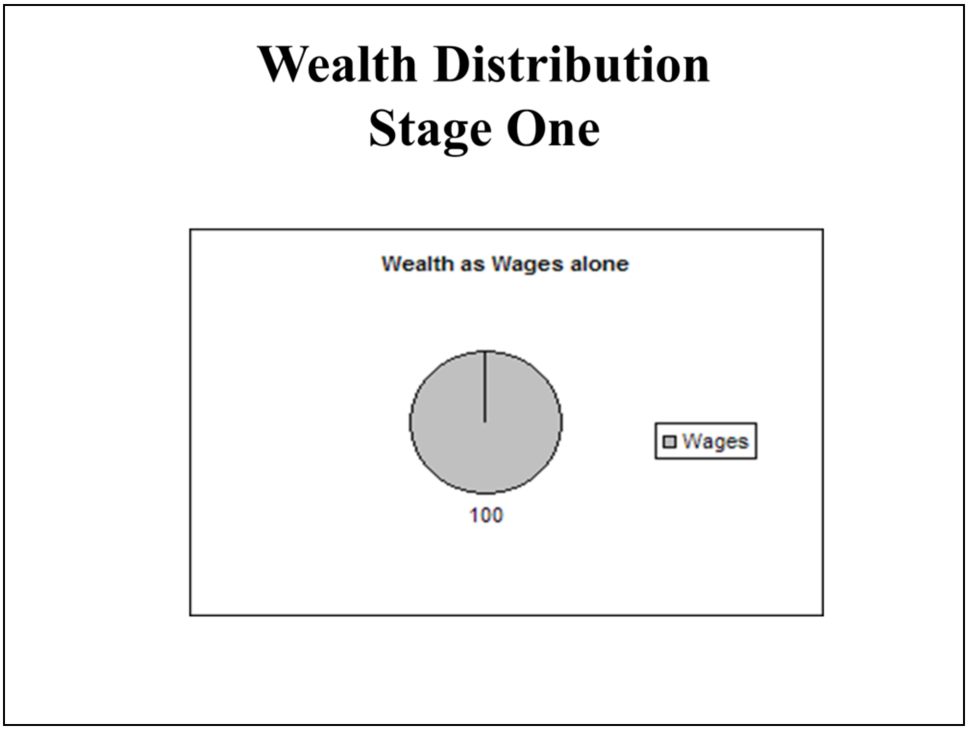
0 10 20 30 40

RENT'S CLAIM ON WEALTH

Looking into the future when all land able to provide subsistence or greater production is fully occupied, the best locations now have an advantage equal to 40 units of output. These 40 units are what constitutes the *rent* attached to these locations. Producers cannot afford to turn over more than 40 units of wealth as rent because 60 units is the minimum required for subsistence. Only when labor productivity increases by the introduction of new forms of capital goods and new technologies will rents continue their upward climb.

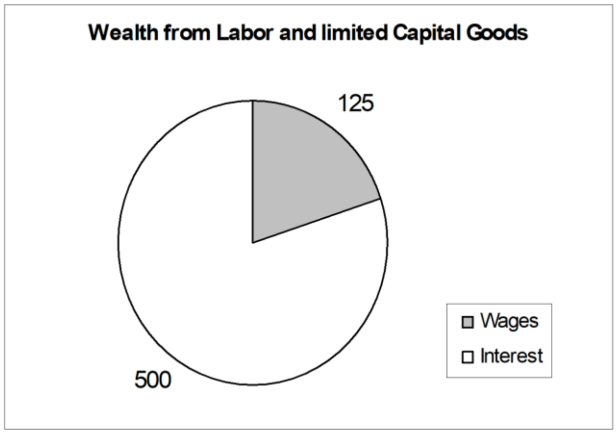


There is another way to show how these relationships change with time and population growth that might make the impact clearer. Just think of how different life in Philadelphia must have been in 1876 from what it was like in 1776.



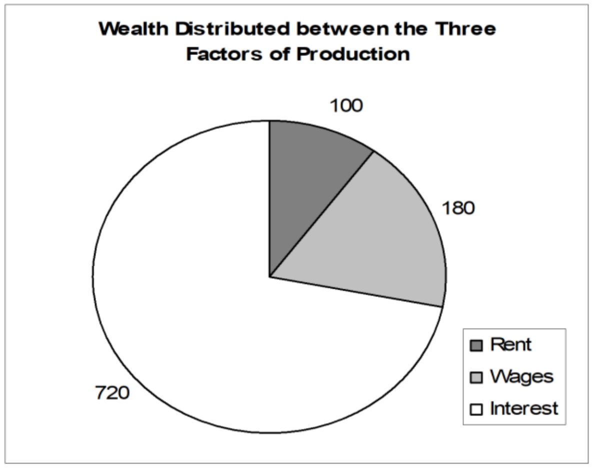
Presented in a somewhat different way by using a circle graph, we see that before we learned to make and use tools all wealth was produced by labor – and all wealth was returned to labor as wages.

Wealth Distribution
Stage Two



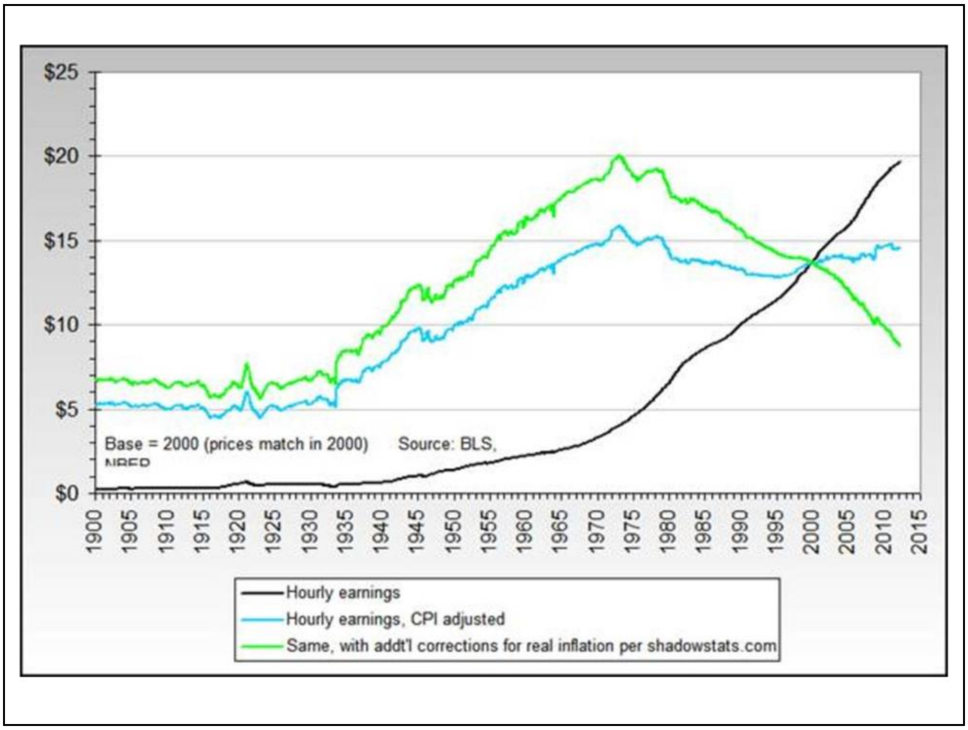
As people learned new technologies and developed more efficient tools, total wealth produced grew dramatically. So long as there were no permanent settlements, wealth was distributed to labor (as *wages*) and to capital goods (as *interest*). At a time when people were largely self-sufficient, working on the land in agriculture, this basic relationship was clear. The modern economy, in which most people are employed by business entities and paid a monetary wage, obscures the fact that labor may be producing greater wealth – that is, wages – than the worker is receiving in monetary compensation.

Wealth Distribution
Stage Three



Settlement meant that eventually the best locations were taken (sometimes used, sometimes held idle). These locations command an increasing *rent*, as a claim on the total wealth produced. Over time, as population generates an increasing demand for land, rent will climb as even quite marginally-productive land commands rent.

However, for those individuals who acquire the knowledge and skills necessary to effectively use new forms of capital goods and ever-more efficiently produce wealth from nature, their actual standard of well-being will improve -- even when the rising rent fund is captured by private interests rather than by the community or society to pay for needed and desired public goods and services.



This chart provides a glimpse into the distribution of income in the United States since the beginning of the 20th century, and why the situation today for many households is one of financial desperation. In the accompanying article written by Jeff Nielson, he explains what the data reveals:

[Source: nowandfutures.com]

"Using the year 2000 as the numerical base from which to "zero" all of the numbers, real wages peaked in 1970 at around $20/hour. Today the average worker makes $8.50/hour -- more than 57% less than in 1970. And since the average wage directly determines the standard of living of our society, we can see that the average standard of living in the U.S. has plummeted by over 57% over a span of 40 years."

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Externalities abound to affect the quantity and quality of wealth produced by labor and capital goods. Natural disasters, for example, destroy enormous amounts of what we produce. Yet, the basic distribution of wealth is governed by the fundamental relations described earlier.

As Henry George explains:

"Where land is free and labor is assisted by capital, wages will consist of the whole produce less what is necessary to induce the storing up of labor as capital. Where land is subject to ownership and rent arises, wages will be fixed by what labor could secure from the highest natural opportunities open to it without paying rent (i.e., the margin of production). ..."

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Progress and Poverty, p.116

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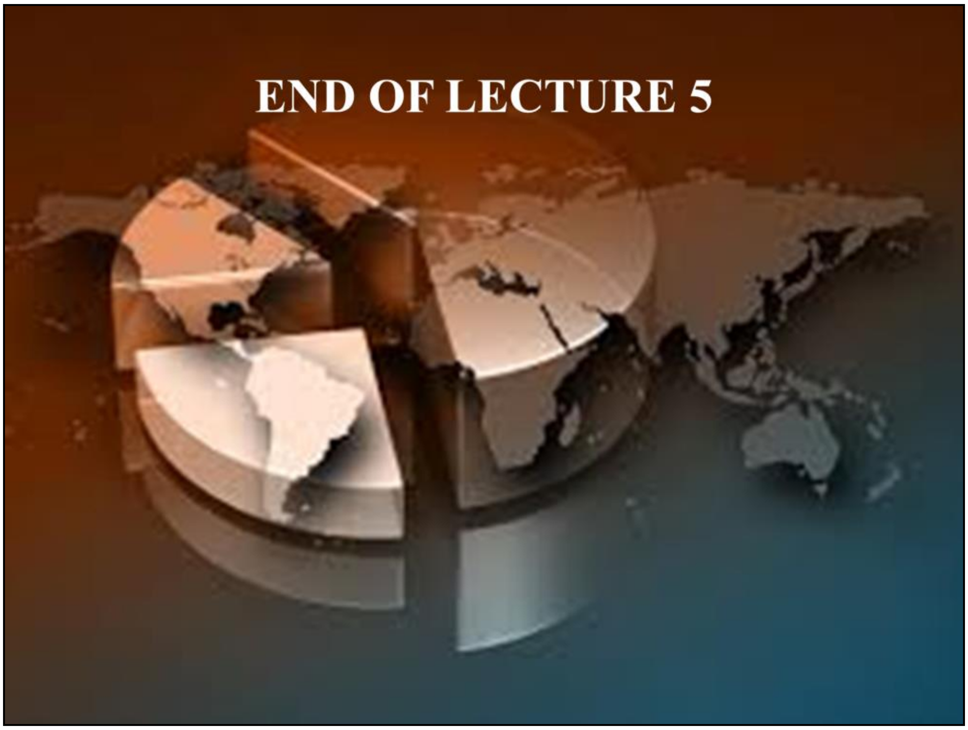
To repeat, these natural laws described by Henry George are laws of tendency, influenced by a long list of what economists call "externalities." How government at all levels raises its revenue is at the top of this list.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