

Review

Reviewed Work(s): *The Corruption of Economics*. by Mason Gaffney and Fred Harrison

Review by: Murray Milgate

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and the real exchange rate should be negatively related.

One shortcoming of the theoretical analyses is the lack of formal modeling of the credibility issue and the ensuing lack of complete markets. A lot of reasonable, but rather informal, arguments are provided for why foreign exchange markets in LDCs should be incomplete and why this should lead to undervaluation of real exchange rates. But no proper modeling of the credibility problems of LDCs or incomplete markets is ever presented, and one is left with the feeling that a lot of other theoretical models, not based on the idea of incomplete markets, may lead to similar testable hypotheses.

It seems fair to say that the major contribution of the book lies in the empirical analyses. The central empirical study, based on a stylized endogenous growth model using cross-sectional and longitudinal data for 62 DCs and LDCs, involves testing whether output growth and the real exchange rate are negatively related. Empirically, this hypothesis is consistently supported by data in a number of different specifications of the model, including simultaneous equation models to take care of possible simultaneity bias, and this is really the upshot of the book that future theoretical and empirical research in development economics should deal with: Is the underdevelopment of LDCs due to undervalued exchange rates, and not to overvalued exchange rates as often argued?

Further empirical analysis of the possible contractionary effects of devaluations and case studies of four development processes (Japan, the Philippines, Uruguay, and Taiwan) seem to provide additional support for the hypothesis that exchange rate overvaluation may not impede growth (although "good governance" is also an important factor for interventions to work well). The policy implication is that in the early stages of development, when credibility problems are more pronounced, government intervention in foreign exchange markets is needed to avoid undervalued exchange rates.

A treacherous property of such a conclusion is that when exchange rate depreciations appear to be contractionary, a logical consequence is that *appreciations* must be expan-

sionary. Thus, if we take the results provided by Yotopoulos for granted, then the less developed countries on, say, the African continent should be able to pull themselves out of their misery by appreciating their currencies! The same implication follows from the work of Edwards (1989), but it is rarely stated in this form, presumably because it looks suspicious.

Given the conventional wisdom and the challenges to it by Yotopoulos (and Edwards), one could conjecture that exchange rate policies seldom are efficient instruments for enhancing growth in LDCs. If future research validates this conjecture, Yotopoulos will still have provoked an advance in our knowledge of the workings of economic policies, and that is in itself a worthy achievement.

To summarize, the strength of this book is the empirical analyses of the relation between exchange rates and growth. The results are quite novel (and provocative) and should instigate further empirical analyses on this subject. What is lacking is a closer connection between the theoretical and the empirical analyses. Observational equivalence is certainly an issue here, and the theoretical explanation put forward by Yotopoulos is only one of several possibilities. However, the empirical results are interesting, even without a more formal linkage to the existence of incomplete markets.

BO SANDEMANN RASMUSSEN

*University of Aarhus, Denmark*

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#### H Public Economics

- The corruption of economics*. By MASON GAFFNEY AND FRED HARRISON. Georgist Paradigm Series. London: Shephard-Walwyn in association with the Centre for Incentive Taxation, 1994. Pp. 271. £24.95, cloth; £10.95, paper. ISBN 0-85683-160-3, cloth; 0-85683-151-4, pbk. *JEL 95-1012*

For those who have never read a Georgist tract—and there are likely to be quite a

few—this volume is exemplary of the genre. All of the familiar features are there: an unquestioned belief in the idea of a universal panacea (in this case the Single Tax), a customary reduction of complex social and economic questions to the unambiguous, the casting of all opponents (however different their backgrounds and arguments) as co-conspirators intent on subverting Truth, and an apparently unbounded faith in the inevitability of the coming triumph of Right over Wrong. Even for skeptics, of which this reviewer declares himself one, the book will prove to be a good read; the more so, perhaps, because this kind of passion has almost entirely disappeared from the literature of economics.

There are four essays in the book under review: the first and third are written by Fred Harrison, the second by Mason Gaffney, and the fourth by Kris Feder and Harrison. However, because the centerpiece of the volume is undoubtedly the essay by Gaffney, I shall focus upon it. This essay provides a systematic (though not entirely disinterested) exploration of the Henry George Episode. While carefully setting it in its historical context, Gaffney also attempts to bring the lessons of that experience to bear upon some of the central planks of what he calls the neoclassical stratagem. Viewed overall, his contribution is interesting, provocative, and witty; it breathes life into an important chapter of the history of economics that, too often, is relegated to footnotes, or assigned only a brief mention in modern treatments of the subject.

Gaffney reminds us that George's *Progress and Poverty* (San Francisco: W. M. Hinton, 1879) was read by millions, created a political sensation at the time, galvanized the thinking of individuals who were to become the founders of socialist traditions in the United States and Britain, and was thought sufficiently important (although the word commonly used by his detractors was "dangerous") to call forth refutations from the leading economists of the day. Gaffney sets himself the task of providing an explanation of why a contribution of such historical moment is so little known (and where it is known, so little valued) today. According to the author the answer seems to be that the fate of the

"Georgist paradigm" has to do with a mostly self-conscious attempt by neoclassical economists to subvert his message. The neoclassical victory was achieved, on Gaffney's account, by a combination of straightforward polemical tactics and a redefinition of the science of economics along lines which made George's ideas seem exaggerated, confused, and wrong.

In tracing the ideological element in the attack on George, Gaffney is in his element. In a series of chapters, he documents the ways in which British and American economists sought to undermine George's views. The account of the reaction of the profession in the United States is especially interesting. Gaffney attempts to show how the leading figures of the day—he singles out Ely, Clark, Walker, Seligman, and Alvin Johnson for close attention—deployed not only their scientific arguments, but also their not inconsiderable power in economics circles, to discredit George and his followers. The impression that emerges is that the two strategies together were required for success; science on its own, it appears, would not have been enough. While not all readers will share the author's belief in the scientific impregnability of the Georgist position, Gaffney's account of the tactics used by the anti-Georgists is revealing.

It should be said, however, that the claim that the "Chicago School" was equally (and energetically) engaged in the same conspiracy, seems to rely a little too heavily on circumstantial evidence (Ch. 8). In the case of Knight, for example, Gaffney appears to offer two main items of evidence: that the origin of Knight's Ph.D. was Cornell (the territory of anti-Georgist Alvin Johnson), and that his position on capital theory was taken from anti-Georgist J. B. Clark. To this reviewer, this part of the argument is strained and unconvincing; resting as it does on guilt by association. Something similar seems to be present in the account of the British reaction.

In Britain, of course, Marshall was George's most influential antagonist, and the account of the famous encounters between the two is informative. Yet when it comes to prosecuting the charge of conspiratorial practices, the story does not ring quite true. Even

Gaffney concedes that Marshall was "more fair" than others (p. 107). He notes the extremely sympathetic position taken by Wicksteed toward *Progress and Poverty* (p. 47), and Edgeworth's opposition to George is said to have been tainted by "class and ethnic bias" (p. 106) largely, it seems, because Edgeworth's family were Irish landlords. There is also a chapter devoted to Pareto, with interesting criticisms of the Pareto criteria, Pareto's Law, and preference analysis. However, because Pareto never mentioned George's name, it is difficult to place him in the camp of conspirators. This said, in the course of his account of the opposition to George, Gaffney does highlight the unfolding tension between the reforming ideals of British economists and the ideology of moderate British socialists (to whom George was so important at the time) in a manner that is at once revealing and to the point.

Of course, there is much more in this book than the space of a short review allows me to mention—taxation policy in the new South Africa to name but one important subject. However, in the final analysis, this reviewer finds it difficult not to agree with Marshall's assessment of Henry George back in 1884: namely, that he was "an able man" but that there was little reason "for thinking that he has the kind of ability which will make a permanent impression on opinion." Nevertheless, it remains true that by reminding contemporary readers that the treatment of land as just one of many factors of production (customarily represented as a vector of quantities in  $n$ -dimensional Euclidean space), upon whose relative prices taxation exerts the usual disincentive and misallocational effects, Gaffney's contribution is both timely and interesting.

MURRAY MILGATE

*University of Bradford, England*

*The economic effects of taxing capital income.* By

JANE G. GRAVELLE. Cambridge and London: MIT Press, 1994. Pp. xii, 339. \$35.00. ISBN 0-262-07158-4. JEL 95-1014

For the last generation, some of the most heated controversies in public finance have dealt with the tax treatment of capital income. For example, investment incentives in

the corporate income tax, incentives for retirement saving, and the tax treatment of capital gains have all been the subject of important policy debates. However, until the publication of this book, capital income taxation had never been surveyed in a way that is both accessible and comprehensive. Consequently, Gravelle's book is likely to be a standard reference work for economists and policy makers for some years to come.

The book begins by asking whether capital income should be taxed at all. It is often asserted that reductions in capital taxation will lead to substantial increases in the savings rate, but Gravelle makes it clear that this is highly uncertain. If we were to replace capital income taxes with a consumption tax or a wage tax, the overall efficiency gains would probably be modest, and it is possible that efficiency losses could occur. A shift away from capital taxation may also have undesirable distributional consequences. Capital taxation presents some notoriously difficult administrative problems, but other forms of taxation suffer from administrative difficulties as well. Gravelle concludes that capital income taxation can be criticized on a number of grounds, but that the case against capital taxation is not compelling either. On that basis, she devotes the rest of the book to a detailed examination of the capital tax system. Although much of the discussion is relevant for other developed countries, the focus is on the United States.

Gravelle has been an active contributor to several branches of the literature. Some of her best-known articles have dealt with the efficiency effects of the corporate tax, the effectiveness of tax incentives for investment, and the tax treatment of capital gains. Not surprisingly, the chapters on these subjects are especially strong.

In these chapters, the author expresses a healthy skepticism regarding some of the policies that have received considerable political support over the years. She is especially doubtful about the value of the investment tax credit. She suggests that this policy might owe much of its popularity to the fact that its distorting effects are not well understood. She also suggests that much of the support for capital gains tax cuts has been based