

THE THIRD WAY = A NEW ECONOMY

Knud Tholstrup

PREFACE

After reading "Land & Liberty" about a proposed trip to Central America by Jeffery J. Smith, San Diego, California, I called up and asked him what kind of printed matter he had explaining Henry George's ideas and how to implement his non-socialistic, non-capitalistic, free trade and free enterprise system. If he had none I would try to write a booklet — and here it is:

The Third Way = A New Economy

The booklet should show a practicable way of converting initiative punishing income taxation to incentive land value taxation.

I take the opportunity of thanking Jeffery J. Smith for his assistance. (Suggestions and linguistic corrections).

Knud Tholstrup

P.S. A Spanish edition will follow soon.

The Danish Experience and Third World Socialism

Inflation and its faithful follower, high interest rates, are problems that beleaguer both industrial Denmark and the agricultural Third World. Interest on borrowed money has risen to the point where Third World nations cannot pay off their debts, endangering the money economies of all nations.

BRIEF STATISTICAL BACKGROUND OF DENMARK

In Denmark in 1957, inflation was 5% and bank interest on loans was 6¼% (both high rates for then). In the election of that year, the Labor Party (the largest Danish party), the Liberal Party, and the Justice Party (the liberal free enterprise party) won enough seats in Parliament to form a coalition. Their program for reversing rising rates was to reduce income taxes and collect rent from all land (locations only, not buildings) at its full market value.

As a member of Parliament (Justice Party), I promised inflation would be brought to a standstill and interest would fall. My words were greeted with laughter from my colleagues in Parliament. After a year however, in the expectation of coming land value taxation, land speculation stopped and land value stopped rising.

Inflation had fallen to under 1% and rate of interest to 5%.

Furthermore, unemployment was barely measurable; 100,000 people (and Denmark have a population of only five million) found a job within the next three years. The deficit in the balance of payments was turned into a surplus within one year, and by 1960 the foreign debt had been reduced from 11.2 billion 1955 Danish Kroner (1,300 million U.S. dollars) to 2.8 billion 1955 Danish Kroner (320 million U.S. dollars) — a reduction of 75%!

Things were going so well, the economy was so healthy, that people forgot what had got them there.

In 1958, I resigned from Parliament due to pressing matters of own business.

Though the general public did not understand the economic forces at work, the landowners did. They launched a campaign against the little Justice Party, the party that had led the legislative efforts to untax labor and capital and tax land.

In the 1960 election, the Justice Party failed to collect the minimum required for seating in Parliament.

The tax reform law that had worked so well was repealed. Quickly inflation climbed back up to 5% and by 1964

was up to 8%. Land values skyrocketed from 17 billion Danish Kroner in 1960 to 320 billion Danish Kroner in 1981, a nineteen-fold increase while prices in general rose only fourfold.

TAX HALT IN 1969

In 1969, Denmark had a brief reminder of what good tax reduction could do. That year, the nation changed from paying tax based on last year's income to a "pay as you earn" tax. For logistical reasons, the government could only collect the same tax as in 1968, so all 1969 income above one's 1968 amount, such as income from overtime work, was tax free. The effect of this exemption can be seen in the chart below.

rates followed and by 1982, domestic bank interest in Denmark was 20%.

To deal with joblessness, the new party in power, the Social Democrats, began redistributing the wealth even before it was created; they borrowed the missing amounts, mainly from abroad, saddling the government with a huge outstanding debt. From 1979 to 1982, domestic debt increased fivefold and our foreign debt three fold. During these three years, the Social Democrats devalued the Kroner 19%, directly causing inflation, followed by rising interest, increasing unemployment by 100,000.

These discouraging trends showed no signs of letting up, so in 1982, the

DEVELOPMENTS IN DENMARK 1967-71

Percent increase	1967	1968	1969	1970	1971
Production (in fixed prices)	4	4	8	3	3
Consumer prices	7,5	8	3,5	6,5	6
Private investments	5	5	20,5	9,5	0
Wage-earner's savings in million kr. (estimated)	2,468	2,857	3,774	3,137	3,059

Not shown is the fact that nearly every last unemployed worker found a job, confirming the saying that "work creates more work".

During the 1970s, another natural resource besides land took off in price — oil, the lifeblood of the industrial West. From the Arabian ground, oil could be pumped at very little cost. The Arab states organized themselves into a cartel, OPEC, and led the way in raising the price of oil from all extractors. Interest

Social Democrats quit, leaving the task of imposing the necessary economic measures for reducing public expenses to the subsequent non-socialist coalition government, the Conservative parties. The new government halted devaluations and borrowed less money which, by 1985, cut inflation and interest in half and increased employment by 140,000. Under these improved conditions, the Social Democrats are again talking about providing welfare (purchasing votes).

The better economic conditions after 1982 also resulted in huge increases in land prices, confirming the claim of the 19c. American economist reformer, Henry George, that "all improvements show up in higher land prices". This sowed the seeds of a later crisis.

HOW INFLATION ARISES

Inflation results when the growth of the amount of money (purchasing power) is faster than the growth of production. On this point, nearly every economist agrees. In 1970 in Copenhagen, I met

with Milton Friedman; we agreed on this definition of inflation but disagreed on the source of this extra purchasing power.

Because land is not produced, it has no cost to its original owner or seller. Furthermore, land *value* is determined not by what an individual owner does but by what the surrounding community does — grow, install utilities, and provide services. Thus without producing wealth, landlords collect money and increase their purchasing power, creating the imbalance that leads to inflation.

How inflation arises:

Development during the year.

Land rent from land value rising created by the community goes into private pockets as unearned income and purchasing power at the cost of the consumers through higher prices for all commodities.

- 1) land value rising is inevitable as long as there is growth in population and standard of living.
- 2) without underlying production.
- 3) more (inflated) money for the same amount of goods.

Total production (G.N.P.)	Total income	Total purchasing power	Total pur. power, inflated
	Land value rising ¹⁾ 10	Surplus pur. power ²⁾ 10	Rising prices ³⁾ 10
Goods and Services 100	Wages and Profit 100	For Taxes 45	For Taxes 45
		For Consumption and Savings 55	For Consumption and Savings 55

How to stop inflation:

Development during the year.

Land value rising being public collected as annual land rent and then used for tax reduction.

- 4) by these means land value rising will increase the amount collected in land rent and thus replace more and more taxes during the years.

Total production (G.N.P.)	Total income	Total purchasing power	Balance without rising prices (no inflation)
	Land value rising ¹⁾ 10	Annual land rent ²⁾ 10	
Goods and Services 100	Wages and Profit 100	For Taxes 35	For the Community 35
		For Consumption and Savings 55	For Consumption and Savings 55

— *inflation is not started by rising wages.*

Succession in the course of inflation:

When the amount of money grows faster than the amount of goods we have inflation, as production and purchasing power get out of balance.

The surplus purchasing power must necessarily come from non-productive sources of money incomes.

The concept "money" includes all means of payment, mortgage deeds and all kinds of I.O.U.s as well as bank notes.

The balance between money and goods is currently established by price rising and then the increase of wages comes. Increase in wages will always be limping afterwards.

Nothing can change this succession:

I. Purchasing power (money) arises from production.

Surplus purchasing power arises from rise in value of existing goods, especially real estate.

II. The total purchasing power exceeds the amount of goods.

III. Prices will rise till balance is established.

IV. First then it is possible to pay higher wages.

But a new value rising is already on its way.

a. In expectation of further land value rising people become interested in buying land and thus the demand is pressing up prices and sales are concluded with promises of later payments.

b. Promises of later payments (mortgage deeds etc.) can immediately be used as payment and thus take part in the demand for goods at the same level as money which comes from production.

c. Expected continuous inflation encourages people to secure their savings by investments in real estate instead of in production.

d. The competition about the savings is pressing the rate of interest up, and this element in turn is a further impulse to raise prices.

Because the supply of land is fixed, especially good land, and the demand for it usually increases as population grows, the price for land tends to rise. Receiving a higher return, owners and sellers of land are encouraged to withhold their sites from use, thus restricting supply and further driving up the cost of using land. Such speculation happens especially in booming periods when many want to build houses and factories.

As true with all others, the cost of location ends up in the production cost, meaning higher commodity prices. Higher prices is the external symptom of inflation. What we don't see is that inflation is actually greater than the final, total cost of a product. Were it not for technological progress increasing productivity and deflating costs a bit, the jump in prices would be even worse. Without inflation, technological progress would lower prices for commodities and all consumers would benefit.

WHY TAXATION BACKFIRES

Because prime sites for business are not used, some people cannot work and unemployment rises. To help the jobless, the government raises taxes on the producers. The cost of production rises and sales lag, so companies dismiss more workers, and the vicious spiral worsens. Furthermore, surrendering a huge portion of the profits through a tax on income puts the brakes on initiative and human energy, thus reducing production.

In *Ekonomisk Debatt* (1977/8), Sweden's former minister of finance with the Social Democracy government, Gunnar Myrdal, the 1974 Nobel laureate in economics, made a remarkable admission:

"The Swedish tax system is too radical and there is much to be said in favor of reducing the progressive income tax considerably, not because I consider the total pressure of taxation too high, but because of the way in which the taxation takes place.

In spite of the progressivity, the result is that people within all income groups must pay, because *the rich are so very few*.

For an old welfare politician, it is depressing to think of the unhappy consequences of our income taxation and especially the bad effects of the high marginal rates of taxation.

Swedish honesty and my own pride suffer because my generation made such bad laws they have made the Swedes into a people of small-cheats.

To this may be added that this tax system requires a huge bureaucracy."

Was it Lincoln who said that you cannot make the poor rich by making the rich poor?

SOCIALISM COMPOUNDS THE PROBLEM

Russia is one of the richest countries by nature, endowed with vast amounts of ore, minerals, coal, oil, and natural gas. With one meter of top soil, her province

The Ukraine in the time of the Tsar had a big wheat export and was called Europe's granary. Today, regarding bread, the Russia is not self-supporting.

Finland was the poorest province of Russia up to its independence in 1917 — without any raw materials and most of the country covered by snow for six months. Today the Russians are relatively poor and must queue up at the shops and the Finns rich, with a standard of living two to three times as high in Russia.

The reason for the difference is the stimulus to work in Finland thanks to free enterprise. Scandinavia experienced much material progress up to the beginning of the 1970s. We must admit that egoism production wise is stronger than altruism.

THE THIRD WORLD

The President of Tanzania, Nyerere, tried a well-intended mix of pure socialism and Scandinavian socialism — which combines private enterprise, to raise the money for social distribution, and the Welfare State. In 1968 I visited Tanzania and found a fair amount of prosperity. The houses in the towns looked nice and had been recently painted. But by 1972 when I revisited Tanzania, everything seemed so poor. Paint was peeling off the dilapidated houses and the people were poorly dressed. Why the sudden downturn? In the meantime, the state had taken over people's property and their responsibility; consequently, nobody cared.

The poverty increased year by year. Only in the school sector did some progress take place. Finally in 1985, when

Nyerere resigned, did he admit that the socialistic experiment had proved to be a failure. Nyerere said:

"We are a poor people, and we chose socialism. But socialism is a luxury and only for the rich.

Socialism maintains or creates poverty and stagnation. It cannot be carried by a community already poor and underdeveloped."

Nyerere's assertion that socialism is for the rich is doubtful. Scandinavian socialism is pretty far along in ruining Scandinavia, too. In Sweden, the marginal income tax is up to 85%; in Denmark, 78%. Denmark in 1985 had a huge burden of interest and repayment to foreign banks to struggle with. We have lost so much of our competitive power that our unemployment is 8% to 9%. In the wake of unemployment, violence and other criminality has spun out of control, too. In Holland even worse.

In Switzerland one of the 4 rich European countries development is opposite. The Swiss never dream of socialism. Switzerland has less than half as many engaged in civil service as the other 3 rich countries in Europe. Real wages is worlds highest.

Highest income tax is 30% — low inflation — low rate of interest — less than 1% unemployment and no foreign debt.

Inflation doubles the rate of interest on bank loans, so the deeper in debt a country is, the harder it is hit by inflation. Denmark is hindered but gets by. The economies of Third World countries, incipient and fragile as they are,

are terribly crippled by inflation and its attendant high rate of interest.

Partly because socialism is an inherently inflationary system, nowhere on earth has it fulfilled people's expectations, despite the beauty of the ideology. On the contrary, people have often lost their personal freedom as well. History is replete with examples of desperate people throwing off the yoke of oppression and adopting a radical change, hoping for more freedom and prosperity, only to end up with new rulers who, having won popular support, abuse the positive ideology and fail to fulfill the golden promises.

Estate-owner government turned into state-controlled administration. The powerful bureaucracy ate up most of the progress while the people obtained the least. In some cases, their conditions even worsened.

WHAT TO DO

Rich capitalists and large estate owners have given free enterprise a bad reputation, but conditions for both liberty and security lie in free enterprise. Enterprise must be freed from all forms of monopoly and the most egregious form is land monopoly. Young Winston Churchill called it "the mother of all monopoly".

Land monopoly can be eradicated without landowners losing their right of disposal — their right to use, sell, or testate a site. All the government need do is charge and collect the rent from a site, determined in the market by the possible uses of the site.

We cannot prevent land from increasing

in value, but we can prevent this increase from hampering our economy. By taking this community-created unearned income out of private pockets and putting it into the public treasury, we can (1) end taxes, (2) lower rents, (3) end inflation, and (4) lower unemployment.

We can end taxes because rent is enough to fund government; no tax would be needed. Rent is lowered because withholding becomes cost-prohibitive; so more good sites will be put on the market, and competition will drive their cost down. Inflation is ended because the value of land returns to those who created the value in the first place — the public. Thus production and purchasing power are put in balance. Unemployment is lowered because production and consumption are increased. Furthermore, with sufficient funds, government would not need to borrow money to build public utilities. Deprived of this business with spendthrift governments, banks would have to lower their interest to attract ordinary customers.

SOLUTION'S MORAL BASIS

A better understanding of the conception of property is necessary.

We must learn to distinguish between private ownership and public ownership, between what rightfully belongs to the individual and what belongs to the community.

A precondition for respecting private ownership of produce is the respect for society's right to the proceeds of the community created land value.

Most wealth — products, houses, factories — is created by human effort and so

must inviolably belong to the individual and should not be taxed away by the community. Some wealth — capital improvements to land (roads, sewers, etc.) — is created by community, yet increases land value. Land itself and the features that give certain sites value — view, soil, harbor, resource — are not created by nor for any particular individual, yet provide the basis for establishing a community. Therefore, all land value is owed to (and public utilities belong to) society and should not be retained by the individual.

Paying rent would be paying a fee for the services provided by the government — roads, police, etc. — and a compensation from the claimant of the piece of earth to everyone else excluded from it. Paying rent upon full market value would be the fair annual amount for a site.

Because we have it in our power to halt inflation and unemployment and prevent any further damage, it is absurd that we don't. We are negligent in that we don't collect ground rent and abolish all taxes.

If collected, rising land value would benefit all people instead of only the few who benefit today at the expense of others. No taxes and greater access to land will encourage initiative and determination; the most clever people will take advantage of most of the possibilities, so the total production will grow — the horse of egoism would be hitched to the carriage of progress. More goods and services will benefit everybody.

Because of the rapid development in rationalism, research, and technology

during the last 20 to 30 years, finding a way to fairly share this new bounty is an imperative today. The program of pooling all land value — driven up by progress — then sharing it among all citizens is the fairest, most efficient way of making modern advances benefit everybody.

HOW TO IMPLEMENT THE SOLUTION

We are all joint owners of the land, but we can't all occupy each other's site. Paying rent to the community according to the value of one's site equalizes everyone's advantages in claiming sites. What is the best way for the community to rent all the land to its members? In switching from the present system of taxing land, labor, and capital to renting all and only land, we need not move too fast, faster than people can keep up with. One way but difficult to practice is to freeze all taxes. Then reduce all taxes except for the tax on land by one tenth over a ten year period. Meanwhile, gradually raise the tax on all land.

In the end, when a tax on land is the only source of public revenue, it will be more accurate to say that the community rents all land because tax and rent differ in crucial ways. Tax arises when rulers want money; rent arises when people use more than two grades of land. Tax is limited by only how much the state can squeeze from the citizenry; rent is limited by the value of land in the market (according to Ricardo's Law of Rent). Tax falls on property, the fruits of one's production; rent comes from "trusterty", the part of Nature one claims. Taxing private individuals hinders production; the public renting to its members enhances production.

Whether renting or taxing land, its value must be assessed. The market does a good job of determining the value of locations in the aggregate, but there may still be certain sites that are rented too high or low, conferring an unfair penalty or reward to various citizens. This may be especially so during the beginning period or relying on land value taxation. Therefore, the government would have to assess the full market value of all sites.

All assessments would be based upon the actual selling price of land. Land has widely ranging values from low on sandy soil on the verge of cultivation, upon which no duty can be placed, to high on busy intersections in the center of shopping districts. The size of the annual duty is determined by the difference in value of a site compared to the poorest one in use — the margin.

Because it's possible to misjudge land's value, and because its lasting value is usually increased not by Nature but by human effort — fertilizing, rock clearing, terracing, draining or irrigating — and because the margin should be free (especially to self-reliant farmers), it would be a good idea to allow room for error and permit users to deduct from the value of their sites the first \$ 2,500 per hectare (\$ 1,000 per acre). To be certain the assessment is fair, it could be implemented over a ten to fifteen year period, so that running adjustments could take place.

Procedure schematic

First year:

1. Assess all land at market value per hectare (or square meter).
2. Impose on all land a duty of 4% of the actual value after the deduction of say \$ 2,500/ha. (\$ 1,000/acre).
3. Register this total after deduction as a permanent fixed annual duty.
4. Use the total yield for immediate reduction of personal income tax on a per capita basis.

Second year:

5. Assess all land on the basis of the actual market value influenced by the burden of the fixed duty and taking the future annual duties into consideration.
6. Impose the new assessment with a further fixed duty of 2%.
7. Register the new fixed duty on top of the previously registered duty as a new fixed duty, totaling 4% of old plus 2% of new.
8. Use the total yield for further reducing income tax.

Third year and further years:

9. Continue the whole process — the same as the second year — with a different 2% value each year after.
10. Use the total yield for reducing all other taxes, too.

To ensure for mistakes any land owner can have the new assessment revised at any time on request.

ADDED BENEFITS

Were we to implement this program, we would not only cure inflation and unemployment and taxation, we would also solve some problems from skewed land value. (1) The market value of farm land where subjected to speculation would fall rapidly. (2) The value of most locations would stabilize because the tax burden is moved from human improvement to natural potential. (3) Development where already intensive, especially where land changes from cultivation to construction, would continue to increase but moderately. (4) Farmers, whose work is hard, will especially benefit from going from a tax on energy and skill that hampers initiative to a duty on natural advantage that encourages business.

More clever and industrious workers could produce more from any site but much more from prime sites, so they would probably outbid others and use the most advantageous site. Access to the best sites would be a great encouragement to these workers. Their output would be a great boon to the rest of society.

JAPANESE TENANTS BENEFITTED

This benefit is borne out by the experience of Japanese farmers after World War II. Before the War, landowners, who mostly lived in towns, collected 2/3 of the yield from their tenants who for their hard work were left with only 1/3. After paying the costs of seed grain and interest, etc., the farmer might get only the last 1/6 of the crop for supporting his family. They lived in utmost poverty until the rule of the occupying American military.

General Douglas MacArthur can be accredited with the democratization of Japan; this admirer of Henry George gave the defeated nation a new constitution which is still valid today. He also reformed rent distribution by reversing the landlords' and tenants' portions, so the farmer got twice as much gross and presumably three times as much net as before. In the course of a very short time, Japan became self-sufficient in rice which was previously supplemented with imports. Also, the tenant could afford a better education for his children.

A similar success story took place in Taiwan, thanks to the influence of Sun Yat-sen, who was also an adherent of George. A recent study by the World Bank gives land reform the credit for these two nations moving from near feudalism to modern industrialization. Land reform of the Georgist variety could work anywhere — Tanzania and Strife-torn Latin America included.

CONCLUSION

The whole world is today struggling with drastic economic problems. We cannot go on with the present situation of inflation raising the cost of production, increasing the number of unemployed, upping the interest on bank loans, and expanding the need to borrow and sink deeper into debt. The vicious spiral grows more vicious every year.

HIGH RATE OF INTEREST CREATE UNEMPLOYMENT

In my younger days when bank rate was 5%, a 10% profit was a good business. When interest rose to 10% it was difficult to get a reasonable profit. When bank rate rose further many had to close down, jobs were lost. And very few found it worth while to start up, and no new jobs were created.

RATE OF INTEREST AND WORLD CRISES

Up to the forties inflation and rate of interest was not a severe problem but after the second world war the development has been so rapid that demands for building land of which no more is produced created a land price explosion and thus an enormous surplus of unearned purchasing power to the benefit of few.

This again has caused high inflation and high rate of interest to the disadvantage for the many.

It has become an absolutely necessity to stop inflation and its true follower high rate of interest.

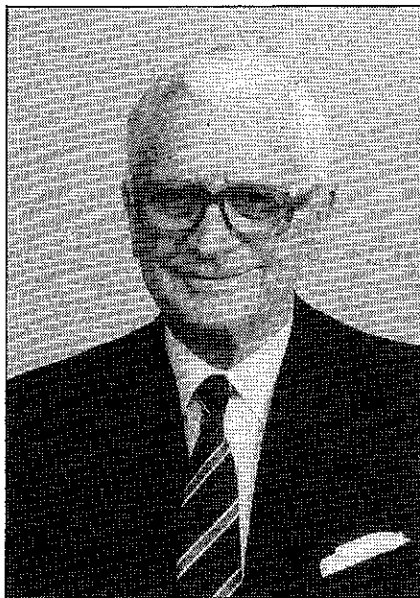
The latter is not only threatening companies and especially poor countries with bankruptcy but also some of the worlds biggest and strongest banks have been severely shaken by their big losses on credits the last years.

The whole civilization is threatened.

The whole world is at a fork in the road. We must choose between traditional ideologies that do not work and an innovative system that has brought prosperity before and can do so again. We must strike at the root of the problem — private retention of publicly created land value.

Liquidating land monopoly would reward initiative and promote production, making the cake bigger for sharing with all, so no one need suffer.

Liberty with prosperity is the only reform worth struggling for. The key is to free people's productive powers of all irksome fetters, and to share the natural advantages in God-given land. Thus we would all be free to work and live in a just world. Justice in economy improves morality.



The author, *Knud Tholstrup* (1904), started as a farmer. In 1936 at age 32, he became an entrepreneur. In 1941 he bought Kosan Gas Co. Later he founded Kosan a/s, of which he is still chairman. Kosan a/s is a conglomerate of 11 trading companies and factories, with foreign affiliates and a fleet of 19 LP-gas tankers ploughing the seven seas, exporting to 100 countries.

Knud Tholstrup is keenly interested in national economy and social justice. During the past 60 years, he has written countless articles about economics. Member of the Danish Parliament 1946-58 (Justice Party), Tholstrup is known as a relentless fighter against monopolies and a spokesman for unconditional free trade and real free enterprise.