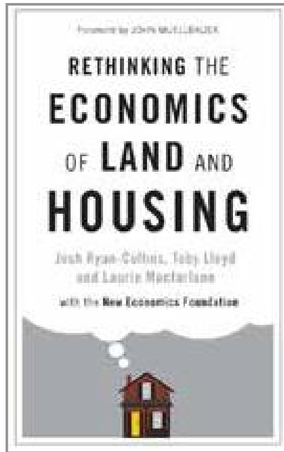
Putting Land and Power Back into Economics



Rethinking the Economics of Land and Housing, by Josh Ryan-Collins, Toby Lloyd and Laurie MacFarlane, with the New Economics Foundation (Zed Books, 2017).

BY POLLY CLEVELAND

Here's a desperately needed new book to revitalize not only urban economics, but our whole approach to economics—micro, macro and muddled. While the authors draw their examples from Great Britain, their lessons pertain far more broadly.

The first section of *Rethinking the Economicsof Land and Housing* reminds us of the central role of land in the "classical" economics of Adam Smith, David Ricardo, John Stuart Mill, and others. The classicals attributed production to three "factors of production": land (including all natural resources), labor (all productive human effort) and capital (all physical tools and inventories used in production). These belonged to three distinct but overlapping classes: landlords, workers, and capitalists, and earned respectively rent, wages, and interest/profit. The landlords were the ruling class, heirs of the conquerors of the territory, deriving their "rent" income from the mere privilege of having titles granted and protected by the state. As Adam Smith wrote in *The Wealth of Nations*, "As soon as the land of any country has all become private property, the landlords, like all other men, love to reap where they never sowed and demand a rent even for its natural produce."

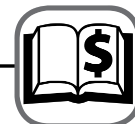
Adam Smith and the others argued that the best tax was one that fell on the market value of land, collecting the landlords' rent. In fact, a stiff land tax of four shillings to the pound had funded consul bonds when the Bank of England was founded in 1694 during the reign of William and Mary, making England a financial powerhouse and setting it on the path to empire. In 1700, land taxes supplied some 35% of national revenue, a number that would fall steadily over the years to negligible levels. In the late 1800s, the American Henry George, author of *Progress and Poverty* (1879) began a worldwide crusade for social justice. He picked up and ran with the classical model; his "remedy" for poverty and inequality was to shift all taxes to land. A national land tax in England, advocated by Winston Churchill, came close to passing in 1909 and 1910; there were several near-successes up to 1938.

Adam Smith and the other classical economists argued that the best tax was one that fell on the market value of land, collecting the landlords' rent.

Meanwhile, the establishment responded to the threat of George, and of Karl Marx, by creating "neoclassical economics." The leading instigator was the American John Bates Clark, for whom is named the award for the best work by an economist under 40. Clark merged land into capital, and rent into profit to give us the static two-factor scheme of capital and labor in today's economics. He also claimed that capital and labor were paid their "marginal product", that is, according to the value of their contribution. Clark's motive was clearly political: to dampen growing claims that labor was being exploited. Somehow land came to mean only farmland, dismissed as mostly irrelevant in an industrial economy. As the *Rethinking* authors state, Clark's model had a huge influence and became the basis for 20th century macroeconomics.

The second part of *Rethinking* develops the history of housing policy in England. The late 19th and early 20th centuries saw increasing urbanization and more widespread ownership of property in England. The authors argue that this brought both "freedom and theft": greater opportunity for property owners, yet theft of opportunity for non-owners, since the overall supply of land is fixed. In the early 20th century British leaders, recognizing the contradiction, developed various programs to provide inexpensive rental housing for workers. Following World War II, there were the "council houses." A government authority purchased land outside older cities at its agricultural value, built infrastructure and modest row houses, and recovered its investment from the affordable rents. Later tax policies increasingly favored housing, notably the exemption of primary houses from capital gains taxation.

After 1970, instead of subsidizing construction of inexpensive rental housing, policies increasingly subsidized homeownership. As the authors make clear, this is a bad idea. More demand for houses without more supply creates a vicious circle: more homeowners → more support for rising home prices → home (land) prices rise as demand isn't



met → more non-homeowners see homes as a good investment → more government support for homeownership → more (now heavily indebted) homeowners. Since land values are the capitalized value of expected land income, low interest rates mean high land values—and pressure on central banks to keep interest rates low.

The authors explain how these policies have led to the financialization of land and housing. They quote *Financial Times* editor Martin Wolf (2008): "[T]he US and UK economies … turned their populations into highly leveraged speculators in a fixed asset that dominates most portfolios and impairs personal mobility." It had to end badly—and did, with the bubble leading to the crash of 2008 and the government bailouts of the banks. Only it didn't really end. As the authors point out, both the surviving homeowners and the big banks still have a powerful vested interest in maintaining inflated land values. The big banks are still loaded with trillions in dodgy land-based assets like securitized mortgages; any increase in interest rates could send them into a downward spiral. The central banks are essentially keeping the largest banks on life support—in the process diverting resources from productive investment by small and medium businesses. The macro models bequeathed by Clark can't begin to accommodate this reality.

(Even with low interest rates, the big banks can still make money on the spread between the near-zero rates they get from central banks and the rates at which they lend. A small spread on a high volume of trading in the international money markets can be quite profitable.)

The big banks are still loaded with trillions in dodgy land-based assets like securitized mortgages; any increase in interest rates could send them into a downward spiral.

I can pick some quibbles with the book, notably the statement that "while the idea of a single tax was hugely popular, it was never implemented." The authors seem unaware just how pervasive the land -tax movement was outside the UK, notably in South Africa, Western Canada, Australia, New Zealand, and Denmark, where land taxes remain alive though diminished. In the early 1900's, a number of U.S. cities including San Francisco, Cleveland, and New York, as well as Vancouver in Canada, instituted de facto land taxation by shifting property taxes from improvements to land—with impressive results as described in Mason Gaffney's *New Life in Old Cities*. In 1934, crusading journalist Upton Sinclair ran for governor of California on a platform including replacing all other taxes with a land tax. He was defeated after a massive disinformation campaign funded by businesses all over the United States.

Another quibble is that the authors, apparently unfamiliar with the mechanics of property assessment, cast doubt on the ease and practicality of land value taxation. Australian and New Zealand assessors would beg to differ. Today's GIS systems make accurate land assessment a no-brainer. Only the political will is missing.

A further benefit of the book is an extensive bibliography.

Since the book was written, the new Scottish Parliament has begun seriously considering land value taxes—a great way to strike at absentee landowners, including Donald Trump. D&S

***POLLY CLEVELAND** is an adjunct professor of economics at Columbia University's School of International and Public Affairs..*

Statement of Ownership, Management and Circulation (Required by 39 U.S.C. 3685)

Title of Publication: *Dollars & Sense* Publication Number: 00120730

Date of Filing: 11/5/17. Frequency of Issue: Bi-monthly. Number of Issues Published Annually: 6. Annual Subscription Price: $23.95. Complete Mailing Address of Known Office of Publication: 89 South St.,LL02, Boston, MA 02111. Publisher: Economic Affairs Bureau, Inc. Editor(s): Alejandro Reuss, Christopher Sturr. Managing Editor(s): Alejandro Reuss, Christopher Sturr. Owner Name and Address: Nonprofit, Nonstock, 501 (c) (3), Economic Affairs Bureau, Inc., 89 South St.,LL02, Boston, MA 02111.The purpose, function, and nonprofit status of this organization and the exempt status for federal income tax purposes has not changed during the preceding 12 months.

Extent and Nature of Circulation: Average # of copies each issue during the preceding 12 months (and No. of Copies of Single Issue Published Nearest to Filing Date, viz. Sept/Oct 2017): (a) Total Number of Copies: 2450 (2500); (b) Paid and/or Requested Circulation—(1) Mailed Outside County Paid Subscriptions: 1388 (1565) (2) Mailed In-County Paid Subscriptions: 5 (15); (3) Paid Distribution Outside the Mails: 864 (802); (4) Paid Distribution by Other Classes of Mail Through the USPS: 12 (17); (c) Total Paid Distribution: 2269 (2399); (d) Free or Nominal Rate Distribution: (1) Outside-County Copies: 16 (12); (2) In-County Copies: 25 (25); (3) Copies Mailed at Other Classes Through the USPS: 35 (34); (4) Free or Nominal Rate Distribution Outside the Mail: 10 (10); (e) Total Free or Nominal Rate Distribution: 86 (81); (f) Total Distribution: 2355 (2480); (g) Copies Not Distributed: 95 (20); (h) Total: 2450 (2500); (i) Percent Paid 96% (96%); Electronic Copy Circulation: (a) Paid Electronic Copies 206 (206); (b) Total Paid Print Copies + Paid Electronic Copies: 2478 (2608); (c) Total Print Distribution + Paid Electronic Copies: 2561 (2686); (d) Percent Paid (Both Print and Electronic Copies): 97% (97%).

I certify that all information furnish on this form is true and complete. I understand that anyone who furnishes false or misleading information on this form or who omits material or information request on the form may be subject to criminal sanctions (including fines and imprisonment) and/or civil sanctions (including civil penalties. Christopher Sturr, co-editor, *Dollars & Sense* 11/5/17.