NATURAL RENT & THE ROAD TO FULL EMPLOYMENT

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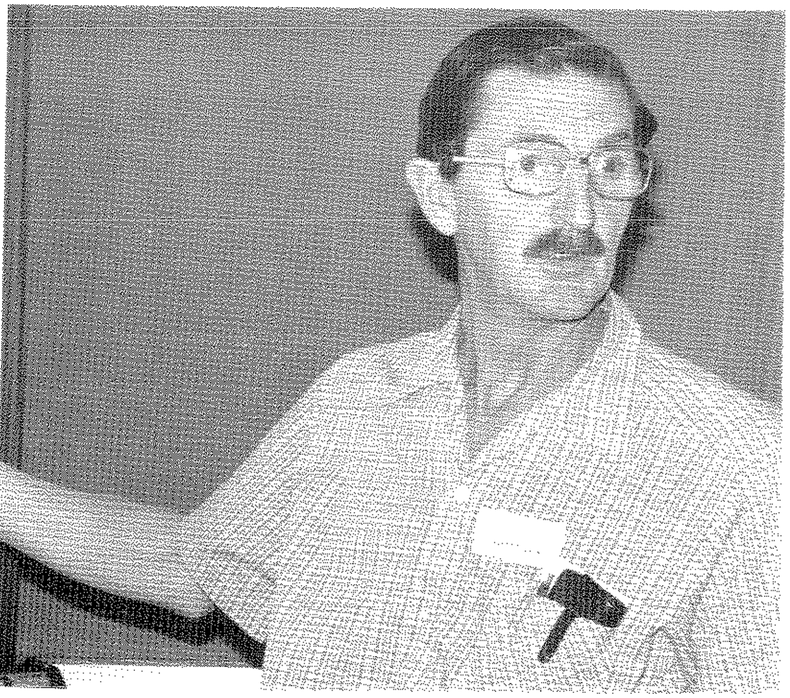
Analysis by

GODFREY DUNKLEY



● Perplexed statesmen wonder why 35m people will be unemployed in the industrialised countries alone by the mid-1980s. Yet they are in large measure to blame for the global recession!

● In Part I of his analysis, Godfrey Dunkley argues that all taxation is at the expense of economic rent. But because it is largely levied indirectly – falling in the first instance on labour and its products – economic processes are distorted. And under existing fiscal arrangements, owners are not compelled to release land for use if taxation removes the whole of their rental income.

● Indeed, the present system – while depressing output and robbing the exchequer of revenue – encourages land speculation. This further reduces the use of land, and increases unemployment.

● In Part II, to appear in the next issue of *Land & Liberty*, the author offers his solution to the macabre situation in which willing hands are denied access to vacant land, thereby consigning people to ever-increasing dole queues.

MANY THEORIES have been put forward recently to explain the origins of the economic disaster in which the West finds itself. Few, if any, of these theories have taken into account the role of taxation.

This may be because of the difficulty many people seem to have appreciating the full significance of taxation as a cause of unemployment, through its impact on marginal land.

In all forms of production, the value added by any enterprise is distributed to labour, capital and land as wages, interest and rent. Wages and interest will be considered as constant in order to better understand the effect of taxation on "economic rent" and production.

Most taxes have the effect of reducing wages to the least that men are prepared to accept, and the tax then comes out of the "natural rent", which is defined below.

Almost any increase in taxation puts land at the margin out of operation and consequently results in an increase in unemployment.

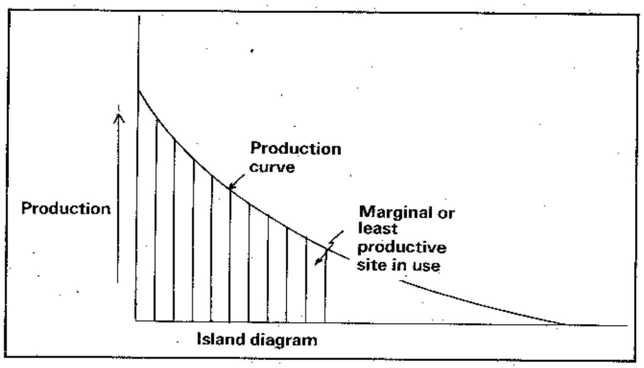
Rent – untapped source of wealth

Rent arises from the productive potential of land or by man's desire to hold tenure to that land, irrespective of its potential. The latter condition applies particularly in connection with residential land.

The "Island Diagram" (Fig. 1) will help to introduce the subject. A block diagram or bar chart compares the productive potential of a cross section of typical sites. This ranges from the best or prime sites to the marginal or least productive sites in use under existing conditions. The production blocks are based on the assumption of the application of equal capital to equal-size land sites.

When a large number of sites are considered in the "Island Diagram" the lines joining the tops of the production bars will be the "Production Curve".

The "General Level of Wages" is governed to a large extent by the production on the marginal sites but reduced by taxation; there is nothing left for rent at the margin. (See Fig. 2.)

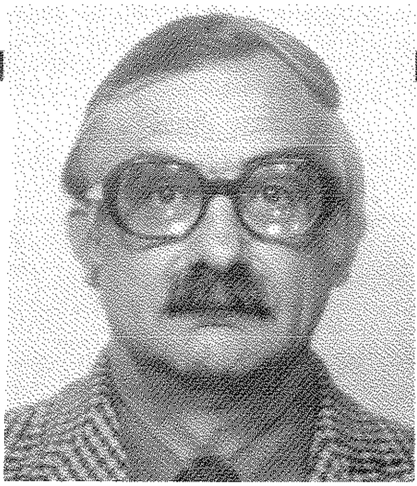


● Fig. 1

On other sites, if you subtract wages, interest and taxation from production, the difference is rent.

Ricardo's law of rent states: "The rent of land is determined by the excess of its produce over that which the same application can secure from the least productive land in use."

By implication and practice, the owner of productive land, after paying tax, can appropriate in rent all the return above that required to compensate labour and



Ron Burgess

Roy Jenkins

Sir Geoffrey Howe

in the tax wedge is a major cause of this," Mr. Burgess told *Land & Liberty*.

He is equally certain that employees do not cause inflation. They may be conductors of inflation but they are not responsible for generating the inflation in the first place.

At best, politicians can object to the fact that employees have resisted the effect of inflationary pressures; but that success was a partial one.

Incomes policies, then, are bound to fail: "There is no evidence that they would affect the trend, because it would seem that the trends are stronger than the government incomes policies that have been tried so far.

"What you usually find is that the incomes policy breaks down after a year or two, and the take-home pay cycle tends to re-establish itself. The policies just muck it about for a year or two – causing a kink in the trend."

"And this is at the same time that the government admit to cutting over £1.4bn from the social security budget in 1982/83, half of which has been taken from pensioners," says the MP for Birmingham Perry Bar.

Equity considerations apart, the government needs to drastically rethink its analysis of what causes the prices of British goods to be at a competitive disadvantage in the international markets.

Income Tax and National Insurance as a percentage of earnings at different levels in 1982-83 compared with 1978-79 for different families.

	⅔Av	Av	5xAv	10xAv
Single	+10%	+5%	−12%	−22%
Married couple, no children	+16%	+8%	−12%	−21%
Married couple, 2 children	+25%	12%	−11%	−21%
Married couple, 4 children	+45%	19%	−9%	−21%

MR. BURGESS, a former advisor to Sir Keith Joseph (the first Minister of Industry in Mrs. Margaret Thatcher's Cabinet), has few doubts about the cause of inflation.

"The underlying pressure for inflation is the slice of the cake appropriated by government as tax revenue, plus the excessive borrowing requirement.

"If the government is trying to take too big a slice of the cake, the main way to do it is out of the share that goes to employees. But if employees won't play, then the government's only answer is to print money. This reduces take-home pay by unexpected inflation."

Official policy, then, has two choices only: either

- Adopt a centrally planned economy, in which economic considerations do not dictate decisions; or
- Leave the free market alone (or limit interference to *improving* the lot of employees, who are wealth-creators, after all).

Unfortunately for the Prime Minister, however, the tensions in her strategy arise from an ambivalent analysis of the causes of inflation.

On the one hand, the government blames employees: hence the attack on trade unions and newly-legislated controls over their power and rights.

On the other hand, her monetary policy is predicated on the theory that inflation is caused by profligate government spending financed by the simple expedient of increasing the money supply faster than the output of goods and services.

Analytical confusion was bound to lead to a mish-mash strategy with no coherent end in view: hence the government's inability to present Britain with a convincing programme for rescuing the economy from the slump.

Will policy be any more coherent after the next election? *It is doubtful.*

U.K. LABOUR COSTS AND TAXES, 1938 to 1981

% of employers' net revenue[1]

	Employers' labour cost[2]	Employees' take-home pay	Pay bargain tax wedge[3]
1938	55.6	52.6	3.0
1946	59.1	52.3	6.8
1947	59.2	52.9	6.3
1948	58.1	51.5	6.6
1949	59.0	51.7	7.3
1950	59.2	52.2	7.0
1951	60.2	53.0	7.2
1952	60.5	53.6	6.9
1953	60.1	53.6	6.5
1954	60.4	53.9	6.5
1955	61.8	54.9	6.9
1956	62.7	55.5	7.2
1957	62.8	55.4	7.4
1958	62.7	54.3	8.4
1959	62.3	54.1	8.2
1960	62.5	54.2	8.3
1961	63.4	54.4	9.0
1962	63.7	54.1	9.6
1963	63.0	53.8	9.2
1964	62.9	53.4	9.5
1965	62.9	52.4	10.5
1966	64.1	52.3	11.8
1967	63.9	51.2	12.7
1968	63.2	49.8	13.4
1969	63.1	48.9	14.2
1970	64.7	49.6	15.1
1971	63.7	49.1	14.6
1972	64.1	50.3	13.8
1973	63.3	49.6	13.7
1974	66.2	50.4	15.8
1975	69.4	50.8	18.6
1976	67.2	48.5	18.7
1977	65.7	47.5	18.2
1978	65.8	48.2	17.6
1979	66.4	48.8	17.6
1980	67.8	49.4	18.4
1981	66.7	47.8	18.9

SOURCE: Calculations by Ron Burgess of the Economic Study Association from the CSO's annual 'Blue Books' and *National Income and Expenditure of the UK 1946 to 1950*, London: HMSO, Cmnd. 8203, p.40, Table 27.

1. Excludes capital consumption and stock appreciation.
2. Employers' labour cost is income from employment plus Selective Employment Tax or National Insurance Surcharge.
3. Pay bargain tax wedge is the sum of income tax on wages and salaries and pay of HM Forces, employees' and employers' social security contributions, Selective Employment Tax or National Insurance Surcharge.

capital at the prevailing rate on the least productive land in use. The "Rent Curve" for a number of sites will thus lie somewhere below the production curve.

At this point, we have to introduce a new concept relating to the "Rent Curve". By definition, the rate of wages and interest will be the same on all sites used to establish the production curve. Thus a base line for rent can be established by the line in Fig. 2. which represents the general level of wages and interest. What lies above it is divided between rent and taxation.

Leaving out other factors which have little influence on this reasoning, with the new base line for natural rent, the production curve now becomes the "Natural Rent Curve".

When taxes that fall on individual sites are subtracted from the "Natural Rent" of those sites, the remainder is the "Economic Rent". For this purpose, it is necessary to lump all taxation together; this includes company tax/VAT/PAYE and others. The "Economic Rent Curve" can then be established.

NATURAL and Economic Rent may now be defined in more practical terms.

- Natural Rent is the "highest consistent annual payment obtainable for the use of land, excluding improvements, provided there were no taxes of any kind."
- Economic Rent is the "highest consistent payment obtainable for the use of land, excluding improvements, under the prevailing conditions."

Economic rent is Natural Rent reduced by indirect or direct taxes on production or wages and increased by most forms of grant or subsidy. In practice, Economic Rent is the market estimate of what remains when all costs of labour, interest and taxes have been taken from the productive potential of land only.*

What factors affect annual rent?

All forms of rent on land are affected by certain common factors. Rent will decrease with –

- Increasing distance from markets, towns and ports;
- Increasing restrictions on its use;
- Decreasing quality of the soil and climate;
- The presence of undesirable factors, such as obnoxious or polluting industries.

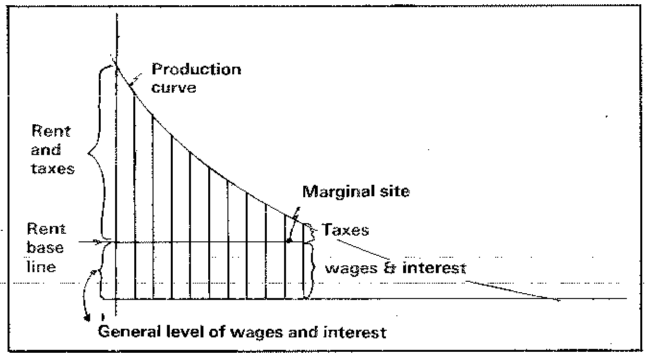
Production is not viable below the margin of production. But this concept of margin is flexible. What is marginal in a sophisticated environment may well be prime in a less sophisticated environment. Each will have its own "margins" of production. Below any "margins", however, land usually lies idle.

Fig. 2 gives a general impression of factors affecting rent and the margin of production.

THE ECONOMIC rent for any and every site will be readily established by the free market. Economic rent is highly sensitive to the variation of a large number of factors which can be grouped roughly under political, economic and Acts of God. Thus the Economic Rent Curve is fluid and will vary from year to year or even overnight. Each variation can have a marked effect on the economy and particularly on employment.

*David Ricardo defined economic rent in Chapter II of *The Principles of Political Economy and Taxation*. It was also set out by Henry George on page 166 of *Progress and Poverty*. Ricardo's definition must be extended to include all uses of land.

An understanding of cause and effect is basic to an understanding of economics. Two of the three groups of variables are not fundamental to the present study, so only the economic variables relating to taxation will be considered.



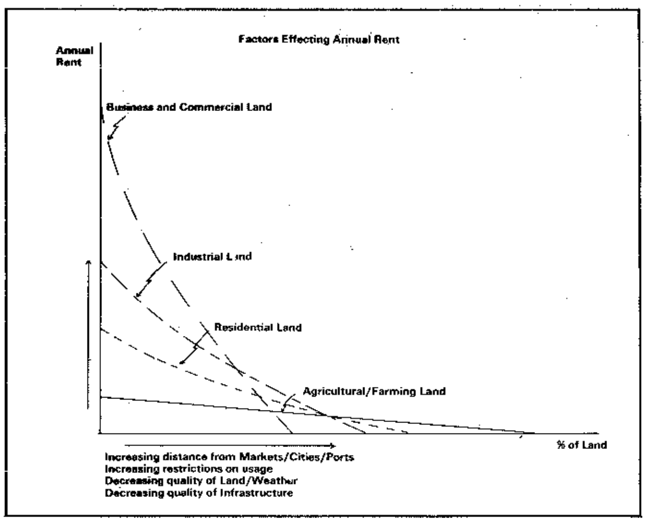
● **Fig. 2**

NOTE: Wages and interest on capital have been left out for simplification in the figures which follow: these will illustrate what happens above the Rent Base Line.

It is necessary to establish a reference point from which the economic rent may easily be assessed for any change in taxation. This reference will be the Natural Rent Curve shown in Fig. 4.

By applying changes in taxation to the Natural Rent Curve, it is possible to estimate with a degree of accuracy the effect on Economic Rent. Any increase in taxation will lower the Economic Rent Curve.

Fig. 4 shows the points where the rent curves intercept the base line and set the position of the relative margin of production.



● **Fig. 3**

In the absence of taxation, the margin of production would coincide with the Natural Margin. As taxes are levied on labour and capital, these are shifted forward on to natural rent, and the curve of economic rent drops lower and lower.

This, in turn, increases the gap between the Natural Margin and the Economic Margin, putting larger amounts of land out of production and increasing unemployment. Clearly a small increase in the sales tax or PAYE will shift the Economic Margin to the left and increase unemployment. This, in turn, wil slow down the economy.

The gap between the Economic Margin and the Natural Margin represents the percentage of land put out of

Turn to P.28

Editor punches home need for land tax reform

NEW HAMPSHIRE editor Dick Noyes is teaching a computer all about land value taxation.

Mr. Noyes, pictured above, has been named by the state legislature's Speaker to serve on a committee which is investigating tax reform.

The Committee to Study Revenue Reform at All Levels of Government will report in May.

And the committee is making use of a privately-funded computer programme set up by a citizen group called the Center for New Hampshire's Future.

The leading options facing New Hampshire are a shift of the property tax on to land values, or the introduction of a five per cent income tax.

Up till now, New Hampshire has prided itself in being the only state to resist a general sales or income tax.

It relies more heavily than any other state on the property tax. And that, acording to Mr. Noyes, is the reason why New Hampshire's economy is the strongest outside the sunbelt.

But there has been a growing demand for property tax relief.

Now Mr. Noyes, who is Deputy President of the International Union for Land Value Taxation and Free Trade, has pushed for a reform of the property tax.

He wants a state-administered one per cent tax on land values, the revenue from which would go back to cities and towns to equalise the burden of paying for schools.

And in a bid to re-shape the property tax, Mr. Noyes has been learning how to feed information into the computer.

A DATA bank, carrying facts and figures about towns and counties and the state itself, has been programmed into one of the main computers at the University of New Hampshire.

What is called a systems dynamics programme – designed to test the probable effects of new taxes through "if-then" calculations – has been structured to help the investigating committee.

Report by
JOHN GREEN

Mr. Noyes has punched in the basic arguments for land value taxation. And he told *Land & Liberty:*

"Initial projections show three things that I had predicted. If population continues to grow, real property tax rates will fall steadily through the century; land values will overtake building values as a factor in the tax base within about ten years; and unemployment will increase if population growth stalls."

And on the basis of what he's learned from the computer, Mr. Noyes says: "They are accurate, fast and stupid. They do exactly what they're told and keep doing it until told to stop! But they are here to stay and we have no choice but to live with them."

He thinks that they can help to reform the property tax if at least half the effort is spent teaching them as has already been spent in teaching people about land value taxation over the years.

MEXICO

Speculators caught in $25bn trap

MEXICANS bought U.S. real estate worth $30bn after the 1979 oil price boom.

But exchange controls imposed last August by the Mexican government, to cope with the financial crisis, has trapped many of the property owners.

For they still owe $25bn on their purchases – but can't get the dollars to finance the deals.

Now the Mexican government has offered to buy the properties off them for pesos in the hope of selling them back to the U.S. for dollars, to increase the country's depleted foreign reserves.

The chairman of a congressional commission in Mexico City says that a law should be passed to stop the flow of Mexican capital into the U.S.

"We can't let this happen again," he said.

LAND TAX WITH A LONG HISTORY

● AN EIGHTH century Act relating to land taxation which is a quarter of a mile long is housed in the Palace of Westminster. It was recently unrolled – as far as possible – in the Royal Gallery of the House of Lords for the benefit of BBC TV cameras.

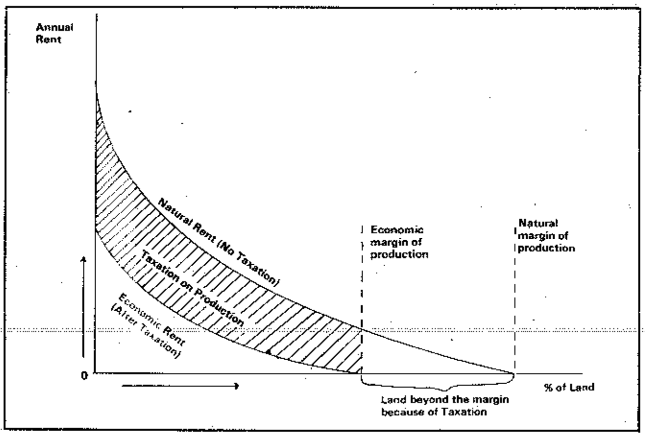
Doubled up!

● SUNNYVALE, a town in the centre of California's "Silicon Valley", was short of homes. So the council rezoned 131 acres of undeveloped industrial land for residential use. The price of land almost doubled to $400,000 an acre.

From P.27

production by taxation. Apart from any other effect, it represents a loss of revenue to the State.

When land at the margin is no longer able to meet both increasing taxes and a return for wages and capital, speculators are able to obtain and hold this land for personal pleasure or against a future demand.



● Fig. 4

Speculation in land, as well as taxation, plays a major part in causing unemployment and the two interact. As the infrastructure improves and population grows, total production – and consequently the Natural Rent – increases. But, at the same time, the authorities incur an increasing debt, to finance the improvements demanded by the growing community.

If all land was fully utilised, however, the expansion of the infrastructure would increase the demand for labour. If all labour was fully employed, the Gross Domestic Product would also increase, followed by rises in the Natural Rent.

But the growth in Natural Rent immediately becomes an incentive to speculate in land. By withholding prime land from labour, an artificial scarcity is created, thereby prematurely inflating market prices of land. In this way speculation leads directly to unemployment. But it does not end there.

The Tax Collector normally receives very little, if any, of the increase in land values which speculation brings about, but he loses when production is suppressed.

Thus a minority of speculators thrive without contributing anything to the economy; it is a case of men being enriched without doing a stroke of work.

[TO BE CONTINUED]