The Science of Political Economy: What George "Left Out"

by Lindy Davies

In the prefatory note to the original edition of *The Science of Political Economy*, Henry George, Jr., who edited his father's unfinished work, said that the author's original intention had been to create a "'Primer of Political Economy" that would "set forth in direct, didactic form the main principles of what he conceived to be an exact and indisputable science, leaving controversy for a later and larger work." However, George's plan changed, because of the great mass of confusion regarding the basic terms and concepts of the discipline, which had intensified since the publication of *Progress and Poverty*. George exhaustively explored and debunked the standard definitions of terms such as wealth, capital and distribution, and the standard explanations of such economic principles as "the law of diminishing returns in agriculture".

In fashioning a version of George's text for use by modern students, a great deal of material, dealing with notions current in George's day, could profitably be removed. His list of the various contradictory definitions of wealth by long-forgotten economists offers little to today's general reader. Likewise, his long discourse on the meaning of space and time, while interesting as an overview of philosophical currents of the 1890s, does little to elucidate economic principles today. Henry George believed that all this disputation was essential to comprehensively making his case. But when his topical wrangling is stripped away, what's left is an astonishingly simple elaboration of the basic principles of economics -- something very much like the sort of "primer" that George originally wanted to write!

Originally, I intended to create an afterword that offered an "update" of a work that could not have been expected to deal with all the problems of the ensuing century. I wanted to suggest, in other words, an outline of how George might have altered his textbook, had he visited the Earth again in the 21st century. However, as I proceeded with the abridgment I realized that I was making the same sort of mistake that the academic establishment has always tended to make regarding George's work. We find none of today's economic buzzwords in *The Science of Political Economy*; however, George also had little to say about the buzzwords of his own time, except as examples of underlying confusion. As a "primer of political economy", George's work still stands. If one uses it as the author intended, as a "template on which emerging details can be coherently arranged"*, it can offer the modern student a

great deal of insight into contemporary questions.

To demonstrate this, I want to briefly discuss some pressing questions for modern-day economics which, though they aren't mentioned in *The Science of Political Economy*, are elucidated by the analytical system it sets forth. The ones I'm thinking of (though others could easily be brought forward) are externalities, environmental policy, business cycle theory (and its relationship to the economic role of government), and globalization.

Externalities

"Externalities exist", writes Paul Samuelson, "when private costs or benefits do not equal social costs or benefits." Thus, externalities can affect aggregate outcomes without changing individual incentives. The fact that externalities have become a big area of concern in contemporary economics might reflect a response to the neoclassical emphasis on individual behavior -- on aggregate phenomena being understandable as the sum of individual choices. That methodology makes externalities a thorny problem. We cannot say the whole is the sum of its parts if the parts affect the whole in ways that cannot be seen by examining the parts themselves. Therefore, external costs (or benefits) are seen as being outside the marketplace.

Henry George's characterization of the "greater leviathan" of the "body economic" alerts us to the fallacy in the above statement. If external costs are costs, then how can they be outside the marketplace? They are paid by somebody, regardless of whether they appear in any formal accounting of transactions. George's analysis is helpful here because he understands the economy to be the aggregate of all production and distribution, whether denominated or imputed, over the table or under it. Hence, externalities are part of the marketplace, regardless of any official action to "internalize" them. If the government were to step in and impose penalties, that would merely bring those costs back within the comfort zone of quantifiability.

George, however, has the classical preoccupation with the entire economy, or the "wealth of nations" -- and it's easy to see that externalities, far from being a new postmodern wrinkle, are a natural and essential part of that analysis. The way that people take advantage of the benefits of civilization is, essentially, by producing wealth and exchanging it. In the laws of production and distribution that George describes, the producer bears the cost of the factors of production, and enjoys the benefits -- wages and interest -- while the community gets the value it created: economic rent. In George's view, these natural laws of distribution cannot be

broken; if human arrangements unwisely go against them, the consequences will inevitably be seen in subsequent production patterns.

In other words, those unwise human arrangements are externalities. External costs are imposed on labor and capital in the form of high rents (which include the speculative increase in the cost of land, plus interest on the money that must be borrowed to acquire land at that price) and confiscation, via taxation, of some of the produce of labor. External benefits are bestowed upon the landowner in payments for benefits that are due to the activity of the entire community. Although economists tend to describe externalities as though they arise mysteriously from some well of market complexity, these, anyway, are directly attributable to arrangements of human law. (And there are many other, lesser examples of legislated externalities, such as the results of zoning regulations, farm subsidies, protective tariffs, etc.)

For Henry George, the question of externalities, and what to do about them, is profoundly simpler than it is for the modern mainstream economist. This is because, for George, the moral basis of property cannot be separated from economic analysis; land is inherently different from wealth. Many pooh-pooh this as merely a moral judgment. But the difference between natural opportunities and the products of labor is so obvious that it can only be denied by an explicit effort to define it away. Natural opportunities are the stuff from which our satisfactions must come, and human labor the means by which our desires can be satisfied. The mixture of the passive element of land and the active element of labor creates wealth -- something essentially distinct from both. Since land is not produced by labor, any income that comes from owning land must be an externality.

If there were no natural principle of ownership, and ownership merely stemmed from an ever-changing social contract, then we could not expect predictable consequences to arise from mucking about with those natural principles. Yet they do. The imposition of absolute private ownership of land distorts the processes of production and distribution in ways that have long been understood.

For the mainstream economist, the problem of externalities is far more complex. Denying the possibility of any sort of "natural law of property" -- and steadfastly refusing to consider the character of land as a separate factor of production -- the mainstream economist is compelled to evaluate each externality afresh, without any guidance except for empirical studies of market behavior. This could lead on the one hand to an excess of regulatory interference, or on the

other to a "social Darwinian" impulse to leave things alone to equilibrate. (It also requires major mental gymnastics in the effort to imply -- if not actually prove -- that land value is not an externality but somehow arises from the landowner's business acumen.)

Environmental Policy

Environmental policy is largely seen in terms of externalities. Firms benefit from spewing greenhouse gases into the atmosphere; foreign debt burdens create perverse incentives to destroy virgin forests and the species they contain; irrigation steals river water from downstream users. But the case-by-case wrangling that characterizes modern environmental policy makes for little progress. Lacking any clear, scientific guide, decisions hinge on a corrupt and/or ill-informed political process. Here, I think, Henry George's political economy has a profound contribution to make.

Henry George affirms the Biblical injunction that "the land shall not be sold forever". That "forever" is important, because it indicates that Georgist political economy, like the Old Testament land law, recognizes the security of land tenure. In fact, George points out that secure tenure is the only way to secure private property in the products of labor. (This lesson has been learned in recent decades by the government of China, which found that privately-owned farms are vastly more productive, per capita and per acre, than collective farms.)

Now this concept -- of *conditional* private property in land -- far from being some archaic notion, is clear to anyone familiar with modern laws concerning real estate. In legal terms, "selling a piece of land" is a *non sequitur*. What is transacted is a "bundle of rights" that attaches to a particular site. These rights could include surface rights, subsurface mineral rights, aquifer use rights, air-space rights, etc. When Henry George thundered "We must make land common property!" his fervor and bluntness unnerved some people -- but he meant it. George insisted that we allocate the bundle of rights according to the moral basis of ownership. Society must grant secure land tenure, refuse to confiscate the products of labor, and "not sell the land for ever" -- by collecting, for society, the socially-created rental value of land.

This simple distinction could go a long way toward solving difficult problems of environmental policy. If the gifts of nature belong to all, then a starting point for environmental policy would be to identify instances in which natural opportunities are being taken for private profit. And if we think of land not just as a square of ground but as a "bundle of

rights", we can think of many applications. Northern-hemisphere industrial nations, for example, use the still-uncut forests of the south to soak up their CO_2 emissions. The opportunity to keep their cars and factories spewing with impunity is worth a great deal to them. The cause of that externality is no mystery: the enclosure, for the benefit of a few, of a natural opportunity -- in this case, the use of the atmosphere as a dump for a particular quantity of pollution.

It would be rash to say that merely "going Georgist" would make a no-brainer out of environmental policy. A great deal of sorting out would have to be done. For an example of how complex this can get, consider the case of car owners who use the atmospheric commons as a dumping ground for their cars' emissions. They enjoy the benefit of high-performance transportation, yet are only as bothered by pollution as everyone else. Clearly that amounts to the monopolization of a natural opportunity. Wouldn't it be fair, then, to charge car-owners an emissions tax? Perhaps it would be -- but there is a whole stew of other incentives to consider. People live and work in a system that virtually requires them to drive a car in order to make a living -- because of urban sprawl and the lack of sensible public-transportation alternatives. Furthermore, the sale of automobiles has been actively subsidized by the public provision of highways, cheap fuel, etc. Should individual drivers be penalized for the full amount of pollution that they spew, or should there be some more systemic attempt at reigning in the built-in misincentives? And, if motorists are compelled, because of rush-hour congestion, to wait in traffic, thus increasing their spewage, should they be further charged for this by means of a tax on highway congestion? Could such a tax be administered equitably, or would it just amount to marketing the privilege of using the public highway at the most convenient times? Do not all these real-world complications blow away our happy fantasy of clear-cut Georgist policy decisions?

The fortunate fact is that they do not -- or at least, not nearly so much as some would have us think. Trying to evaluate economic phenomena in their moment-to-moment context is like trying to identify scraps of paper in a hurricane. It makes for challenging doctoral thesis topics, requiring ever-subtler mathematical modeling. But in the broad public-policy areas that we are dealing with here -- the ones, after all, that are the most important -- it isn't necessary. To see why, we have to remember two important facts:

1) Natural opportunities are functionally different from wealth, and can be clearly identified as such. The factors of production are plainly different from each other. Let's imagine factor payments as three colors that get mixed together in the gross

receipts of a firm: land is green, labor is red and capital is blue. Mixed together, they become brownish-gray. It's awfully hard to get any of the original colors out. But before they get mixed, Georgist policy calls for the land portion to be taken -- while it is still green -- and then the entrepreneur's profit can be appropriately purple.

2) Although public policy decisions work through the "body economic" over time in complex ways, Georgist theory reassures us that if those decisions are properly based on "association in equality"* from the start, the resulting interactions will also have that character. Let's consider a (negative) example. At the turn of the 20th century, New York City, responding to its tremendous need to move people efficiently about the city, created a public transportation system (fortunately) before the automobile came into widespread use. The system worked so well that it still carries some seven million riders a day, helping New York City, despite all its other urban problems, to achieve a level of economic dynamism that other cities cannot match. However, the primary beneficiaries of this system -- the city's landowners -- have not been called upon to pay for it; instead, it is charged to the riders and the general taxpayers. Because rent was not charged to landowners, land speculation was encouraged, which retarded the city's economy. Revenue was always a problem, and in time the subway system fell into disrepair. Meanwhile, the (heavily subsidized) national mania for cars and highways threw huge, neighborhood-destroying, revenue-sapping freeways across the city. This is not (necessarily) to say that a sensibly funded and planned city would have no highways at all. But, had the public transportation system been supported as it should have been, by the land rents it helped to create, it could have been provided as a free service, would never have had to suffer from neglect and decay, and would have provided a more viable alternative to highways. Surely that would have made for a more tractable set of urban-planning problems.

A shift to the Georgist paradigm in public revenue will not magically answer all our questions. There are vital debates about, for instance, whether straight land value charges, or severance taxes, or a mixture of both, would be best to secure equal rights to mineral resources, and their efficient use. There are debates over how rights to global resources, such as geosynchronous orbits, or the atmosphere itself, should be assessed and charged. Nevertheless, the fundamental principle that the value of natural opportunities must be collected for common benefit is a powerful de-obfuscatory tool, as useful in the academy as it is at the grassroots. (For further analysis, take a look at Mason Gaffney's Economics in Support of Environmentalism")

The Business Cycle

Nowhere is the potential for liberating simplification shown more clearly than in the Georgist theory of the business cycle. This is an area of today's public policy that seems complicated beyond any hope of clarity. There is this bewildering interaction of international balance-of-payments, domestic savings levels, fluctuating currency prices, swinging equity markets, see-sawing rates of unemployment, consumer confidence, geopolitical threat levels and (probably) sunspot activity. For Keynes the business cycle was an inherent feature of the modern economy, a negative by-product of an otherwise highly successful financial system. For Marxists it augurs the eventual fall of capitalism under the weight of its quest for ever-diminishing profits.

Yet George, in setting forth what he deemed necessary for a basic understanding of political economy, never mentioned the business cycle at all! Now, to be sure, he dealt with the question extensively in *Progress and Poverty;* understanding the "paroxysms of industrial depression" was a major focus in that book. He identified the phenomenon of land speculation as the root cause (underlying the myriad proximate causes) of the business cycle, showing how the tendency to boom and bust was merely a special case of the overall problem of poverty amid progress.

The job of political economy, according to George, is to understand the natural laws that govern the production and distribution of wealth. But the business cycle is caused by a refusal to conform society's property relationships to those laws. For Georgists the business cycle is not part of the economic organism, but rather a disease -- a chronic disease, to be sure -- yet one that can be fully cured. To the extent that the annual value of natural opportunities can be collected, and taxes on labor and capital abolished, the problem of the business cycle can be solved. That's why *The Science of Political Economy* "fails to mention" the business cycle, except as an example of the consequences arising from interference with the distribution of wealth.

What, then, does this say about the role of government in a system informed and corrected by Georgist principles? Here again, there is little need for the "basic primer" to go into specific cases when the guiding principle is so clearly stated. Rewards attributable to labor and the products of labor go to those who provide the service; rewards attributable to natural opportunities or to the entire community's activities go to the community. (The rent fund always directly affects the community's vitality and health: either positively, as when it is collected and used for common benefit, or negatively, as when

it is left in private hands and a syndrome of social pathologies results.)

There is a certain class of activities, often called "natural monopolies", whose value is created by the action of the State. George recommends that such enterprises, which by their nature do not permit competition, should be operated by the government. In his other works he discusses various examples of these things, but in *The Science of Political Economy* he focuses on one only: money. This is because other monopolies come and go with changes in time and technology, but money is an essential part of political economy.

For George, "bad money" (i.e., money with less intrinsic value) drives out "good money" because the fundamental usefulness of money is to save labor in the process of exchange, and it takes less labor to provide credit money than commodity money. He notes many historical examples in which the debasement of currency has led to ruinous inflation. But, he reasons, currency can easily be debased -- in fact its commodity value can be utterly removed -- without any harmful effects, if only its supply is kept carefully regulated. This leads us to realize that the most efficient way for currency to be issued is by government fiat. If any profit is to be gained from issuing money, it should go to the general treasury, and not to private banking interests. In other words, the essential nature of money indicates that, at a sufficiently advanced stage of civilization, it must be issued by government.

There is considerable disagreement, even (or perhaps especially) among advocates of Georgist policy about the precise role of money in society and how to secure a just, stable supply of the stuff. Nevertheless, it is clear that the beacon of the natural law of property as a fundamental guiding principle can bring us far closer to the goal of comprehensibility in questions of public policy. It allows us to evaluate the role of government in terms of basic principles, rather than merely as month-to-month crisis management.

Globalization

Today's "anti-globalization movement" responds with something very much like panic to the economic realities of our time. And well it might: the "internationalization of production" seems to come along with a host of frightening problems: the erosion of wages and regulatory standards, the disappearance of habitats and species, the possibility of irreversible climate change, corporate predation of workers in nations struggling under the burden of foreign debt, the decline of labor unions, the decline of manufacturing in the United States. Understandably worried as folks are, though,

most are not clear on the causes of these problems. The increasing fact of a "global economy" frightens people -- but why, exactly? International trade has been going on for centuries, despite persistent attempts to choke it off (to benefit some special interest) via tariffs or blockades. Lately, improvements in transportation and communication have made it easier for producers to move parts of their operations overseas -- but can technological progress be blamed for today's economic woes? After all, both international trade and technological progress have the potential to increase production with the same amount of exertion, or to achieve the same level of satisfaction with less damage to the environment. Yet those things are not being done: why? "Because the corporations are in control" is the next common answer. "Corporations use their henchmen in the WTO to erode national sovereignty and become more powerful than nations. They skim off all the benefits for their richest one per cent, leaving everyone else worse off."

This is true; income and wealth are becoming more polarized all the time. Yet one wonders how the corporations manage to seize regulatory control from the grasp of sovereign nations. The standard answer is that in today's "global economy" a nation must -- in order to be able to sell its goods abroad -- play by international-trade rules that are set by the corporations. A nation that tries to stick with minimum-wage, worker safety or environmental regulations will not be able to compete in the "race to the bottom" with other countries that are even more desperate.

It ought to be pointed out, though, that not one of these "desperate" national governments has taken advantage of its power to resolve the underlying, fundamental problem of poverty -- which it shares with every other nation in the world today. That is the secret of the "merry-go-round" that no country can seem to get off of. Every player in the "global economy" today allows individuals and corporations to own land in fee simple, and every nation imposes taxes on labor and capital. In addition, many of the world's nations struggle under a burden of foreign debt, contracted by earlier regimes, almost never with the people's say-so. The borrowed money was mostly squandered, and the debts, which ballooned as the United States fought to contain inflation in the early 1980s, are essentially unpayable. Yet in return for "debt relief", nations must impose "austerity" -- further cutting back on needed investment in infrastructure, education and public health.

It is this pattern of fundamental injustice, and the inefficiency it brings about, that is really at the heart of what people see as the "death force" of globalization. Once again, Georgist political economy furnishes a guiding principle that allows us

to make sense of a wide range of seemingly disparate effects -- and provides clear policy alternatives. Indeed, if a few nations were to succeed in implementing Georgist public revenue policy, they could begin a "domino effect" far greater than the "red menace" nightmares of the old cold warriors. This outcome would be good for workers and producers, but disastrous for the special interests that currently run the show -- which provides even more support for Prof. Mason Gaffney's contention, in *The Corruption of Economics*, that even now, a large part of the intellectual power of mainstream economics is spent on making sure that these guiding principles, in all their powerful simplicity, do not become widely understood.