

**LESSON 6 — DEPRESSIONS AND RECESSIONS**

Student \_\_\_\_\_ Score \_\_\_\_\_

Reading Assignment: Book V, especially Chap. 1; Book VI, Chap. 1 only.

*Having seen the effects of material progress on the distribution of wealth, we are ready to apply our findings to the basic problem of poverty and depressions.*

**Depressions and Recessions**

1. a) What is a depression? (264-265; 145-146; 4 pts.)  
  
b) What is a recession? (4 pts.)
2. What are some contributing causes of depressions and recessions? (263; 145; 4 pts.)
3. What does George state is the basic cause of depressions? (263-266; 145; 4 pts.)
4. What is the effect of land speculation on:  
a) the margin of production?  
b) rent?  
c) wages and interest? (264; 145)
5. With increasing land speculation, what is the effect on production? (264; 145; 4 pts.)
6. How does a stoppage of production at one point affect other points of production? (264-265; 146; 4 pts.)
7. In an open market, what is the effect on production of:  
a) speculation in commodities? (4 pts.)  
  
b) speculation in land? (267; 148; 4 pts.)

**The Basic Cause of Depressions**

8. What is trade? (268; 148; 4 pts.)
9. What is the result of a cessation of demand? (269; 149; 4 pts.)

10. Where must all production begin? (269; 150; 4 pts.)

11. What is the main obstacle which prevents labor and capital from producing? (273; 151; 4 pts.)

12. What three conditions contribute to restoring production after a period of recession or depression? (265 & 281; 146 & 154; 4 pts.)

13. When productive activity is resumed, what is the effect on land values? (281; 154; also see supplement; 4 pts.)

14. Is the problem of depressions and recessions essentially different from the general problem of poverty? (282; 154; 4 pts.)

### **Proposed Remedies**

15. Name six measures frequently proposed for the alleviation of poverty. (300; 165; 3 pts.)

16. What effect would economy in government and reduced taxes have upon the general level of wages? (300-303; 166-167; 4 pts.)

17. Can skill, industry or thrift raise the general level of wages? Explain. (303-310; 168-170; 4 pts.)

18. When a labor union raises wages in a specific industry, what is the effect on the general level of wages? (313; 172; 4 pts.)

19. Could cooperative industrial organizations raise the general level of wages? (313-316; 174-175; 4 pts.)

20. What is George's objection to governmental regulation of the economy as a remedy for poverty? (319-321; 176-177; 4 pts.)

21. Have current governmental programs to eliminate poverty been successful? (4 pts.)

22. Can a more general distribution of land raise the general level of wages? (321-327; 178-179; 4 pts.)

*(See Supplement for a discussion of some current theories and measures. In the next lesson we will take up Henry George's remedy.)*

## I. Theories of the Business Cycle

According to J.M. Keynes, whose theories have had enormous influence, the business cycle is caused by a divergence between planned savings and realized investment. If savings exceed investment, national income and employment fall. Something must be done to encourage investment and thereby consumption. Keynes proposed increased government spending and lowering of interest rates. If there are inflationary effects, they are supposed to be adjusted with increased taxes and higher interest rates.

The Keynesian theory deals with effects rather than causes. It supposes an “unwillingness to invest” but does not reveal why this unwillingness exists. As Henry George points out, land speculation lowers the returns to capital and labor. This is the basic, structural cause of slow investment in productive enterprises.

When people are hit by inflation, their incomes do not meet rising prices. They are certainly not helped in this problem by higher taxes and higher interest rates. Keynesian theories, after years of application, were revealed to be inadequate with the development of “stagflation” — a condition of inflation accompanied by stagnant economic conditions. (See Part 3 below.)

These inadequacies led to other theories, notably those of Milton Friedman and the monetarists, who say that changes in the money supply are the prime cause of contractions or expansions in the economy. This is called the “Quantity Theory of Money”. They propose a monetary adjustment rather than an adjustment of interest rates or fiscal policy. The basic plan proposed by Friedman is a steady increase in the quantity of money of 4 or 5 percent a year as a cure for recessions.

This theory does not take sufficient account of the real distribution of wealth. Unless labor and capital can reap an adequate return, the increase in money supply will not help them, as the same proportion will go to unearned income as now — probably even an increasing proportion — with the same recessionary results. This has been borne out by unsatisfactory results in carrying out monetarist policies.

Inadequacies of the monetarist theory have in turn led to criticism by the supply-side economists (Arthur B. Laffer and others). They have recognized that the problems relate to the production of real wealth rather than monetary policies. They focus on tax policy and point out that heavy taxation of production discourages it and even reduces public revenue. Lighter taxation therefore would encourage production. Supply-siders, however, have little to say about the primary distribution of wealth. *Progress and Poverty* discusses the short-term benefits of a reduction in taxes, but shows that the long-term effect, unless more basic rem-

edies are undertaken, would leave us pretty much as we are.

Henry George’s explanation of land speculation as the basic cause of depressions deals directly with the problem of restricted production and maldistribution. He does not stop with a remedy that only encourages production but seeks one that provides for a just distribution as well.

## 2. How Does the Business Cycle Work Today?

Labor and capital must have land in order to produce. What do they do when land values advance? They cease production. What does this mean in real life? Labor and capital decline to buy or rent land at the high asking prices. Some will rent or buy less land, and

### DEPRESSIONS AND LAND VALUES

*The relation between depressions and land values was shown in a study made by Homer Hoyt on 100 years of land values in Chicago, from the city’s beginnings in the 1830s to the depression of the 1930s. Here is a summary of the findings:*

1836: Building of Chicago Canal caused a land boom. Population increased from 500 to 4000. Land values reached \$10,500,000, making profitable use of land impossible. First major depression.

1856: Chicago became the railroad center of the West. Population exceeded 80,000. Land values increased to \$126 million. At these prices, labor could not make a living. Then came the second major depression.

1860/65: Civil War. Wartime needs for wheat and meat stimulated production; land prices increased sharply.

1871/73: Chicago fire and post-war boom. Population 187,000. Land values increased to \$575 million. Third major depression.

1876/92: Land values dropped to \$250 million in 1876. Production and building resumed. New frenzy of land speculation. Land values in 1892 estimated to be \$1 billion. Then came the fourth major depression.

1909: After many industrial failures and great unemployment, land values shrank to half what they were in 1890, though the population of Chicago was twice as great. Business improved and unemployment decreased.

1917/27: World War I and post-war boom. Much apartment construction. Land values in 1921 reached \$2 billion.

1928: Land values reached \$5 billion. Many records of increases of 1000% between 1915 and 1928. Labor could not pay this price and continue to live at its accustomed standard. Then came the fifth major depression.

1929/30s: Foreclosures erased more than \$2 billion of land value; bank failures, unemployment, deep depression.

This sequence shows industrial progress followed by land speculation, followed by depression; then shrinkage of inflated land values and consequent resumption of progress, with the cycle repeating itself. This was not limited to Chicago; a similar picture could be drawn of any large, growing city.

use it more intensively. Some will sleep on the street, or sell from the sidewalk. Some will retreat to little patches of marginal land. Some will buy as much land as ever, but thus use up funds they otherwise would have used to improve it, becoming withholders themselves. Some will pass counterproductive rent-control laws. The economy-wide result will be less production, more unemployment.

Modern-day economists need to ask this question: *How do investors react to a set of incentives where expected changes in land value are made part of the overall return on investment — and land price part of the investment on which return is figured?*

This has several results:

— Many are screened out by the increased need for credit.

— Rising land value becomes part of the incentive to build, leading to a glut of luxury housing and a shortage of moderately-priced housing.

— Land value becomes collateral. Its wild swings destabilize credit and money.

— A lot of land is unused, (or run down in its present use), as the holder waits for a possible higher use.

### 3. Land Speculation and Inflation

As with depressions, there are many different theories of the basic cause of inflation. But since today's business cycle seems to involve a constant tension between periods of inflation and periods of unemployment/recession, the two phenomena clearly are linked.

George identifies land rent as an income for which no production is needed; it is, in effect, a tax on production, the burden of which increases as production increases, due to rising demand for the same supply of land. The tendency of this process is, as we have seen, to eventually raise land rents beyond the ability of labor and capital to pay them — and depression is the result.

Is there any way that this process can be forestalled? Yes: the money supply could be increased. Remember, what landowners gain, in a growing economy, the producers of wealth (laborers and capitalists) lose; how, then, can production continue to increase? The effect can be blunted an increased the money supply. Real wages might be in the process of declining, but people would be getting a greater number of dollars in their paychecks — and they will try to spend them while they can. Thus, an increase in the money supply can create a surge in demand, keeping a period of economic growth alive — at least until the next election. Eventually, increased rents will consume the value of the extra money. Then, one of three things must happen: either the money supply must be increased further, risking runaway inflation — or some way must be found to increase worker productivity — or there must be a recession.

After the Great Depression of the 30s, nations began to use Keynesian fine-tuning of government spending and interest rate levels to blunt the impact of the boom-bust cycle. Since then, “capitalist” economies have teeter-tottered between periods of inflation and unemployment. Employment surged until inflation started to heat up, then monetary brakes were applied, inflation slowed down, and unemployment started to rise. It seemed possible to carefully steer a nation's economy between the two extremes.

Then, beginning in the 1970s, the phenomenon of “stagflation” — a period of simultaneous high inflation and unemployment — began to rear its ugly head. The power of governments to contain these bad economic effects seemed to have diminished, and we were forced to accept higher residual levels of unemployment.

Today, economists define a “full employment” point which is the highest level of employment that can be achieved without an unacceptably high level of inflation (the point is usually reached at an unemployment level of four to six per cent). Why would this be so?

Economists recognize two main kinds of inflation. **Demand-pull** inflation occurs in a growing economy in which increased demand for goods and services leads producers to raise prices to cover the increased costs of meeting the quickly-growing demand. **Cost-push** inflation occurs when a “supply shock” — a rise in the cost of some vital material or resource — raises the cost of production, and hence the market prices, of goods whether demand is increasing or not. It's easy to see that a combination of the two could result in stagflation.

That is exactly what Henry George is describing, in his theory of booms and busts. In a growing economy, land rents increase faster than overall growth. This creates an incentive for more land speculation, further increasing land rents and prices. Higher rents cut into wages and power production: a “supply shock” which grows more severe as the economy increases its output!

George's reasoning, combined with a modern macroeconomic analysis of inflation, confirms that inflation and unemployment/recession are not in opposition — they are different sides of the same coin. Land speculation does two things to create inflationary pressures: 1) It increases the volatility of the economy, creating more severe swings and a sharper demand-pull climate when things are moving upward. 2) It creates a growing cost-push effect by creating a general increase in the cost of land, exacerbated by unproductive land- hoarding. Thus we are led to suspect that if we could rid our economy of land speculation, we could erase the tendency for economic growth to lead to high inflation. We are also led to suspect that unless land speculation is removed from the economy, full employment can only be achieved at the risk of high inflation.