

Unearned Income as a Barrier to Free Enterprise

Excerpt from Mason Gaffney, "Tax Treatment of Land Income"

The victory of market economics over socialism is alloyed with failures, more than enough of them to temper our *hubris*. Some of these are the same kinds that spoiled the good name of economic freedom in the laissez-faire climacteric of the late 19th century, and led to populism and then the Progressive Movement in the United States, and radical liberalism, Fabianism, and then the Labor Party in Britain. They are the same kinds that spoiled the New Era of the Roaring Twenties and led to the New Deal, Keynesian "socialization of investment," and all that.

We scarcely have time to congratulate ourselves on "winning" before confronting failures like the growing concentration of economic power, growing inequality of income and especially wealth, stagnant or falling real wage rates, homelessness and beggary, chronic unemployment, growing crime rates and personal insecurity, low domestic capital formation, obsolescence in the face of rising foreign competition, dangerous dependence on foreign oil, growing recourse to the underground economy, falling literacy and educational attainments, anomie and substance addiction, rampant self-seeking and predation, falling affordability of housing, and rising social divisions leading toward class warfare.

After centuries of trial and error, capitalism still suffers from a deep-seated flaw serious enough to overwhelm the vulnerable most of the time, and topple the strong in periodic crashes. Each time we slip into another recession, as in 1990, we have to ask, "Is this the Big One?" When we see the rich grow richer by unproductive means, and workers grow poorer by producing wealth, we have to ask, "Is this capitalist justice?"

The thesis here is that the structural flaw in capitalism is our tolerance of unearned income and wealth. The idea of free markets is that income should go to incite and reward productive activity; wealth should incite and reward saving and capital formation. Unearned income and wealth do neither. Unearned wealth today (like slave-owning in the past) actually deters saving by the fairly obvious route of satisfying the owners' need for the security of wealth, without their actually creating any capital.

Unearned wealth stigmatizes all wealth as the beneficiaries wrap themselves in the flag of free enterprise. Too many leftist critics in effect join semantic forces with the beneficiaries of unearned wealth by letting them misuse that flag, undenounced. Then leftist critics use the drones as cause to attack the very flag that covers their nakedness. Karl Polanyi attributed depression, Bolshevism, and fascism to "the Utopian endeavor of economic Liberalism to set up a self-regulating market system"—not a word there about unearned wealth. It is this camouflage and confusion we must penetrate if we are to gain from the fall of the Berlin Wall. Let analysis separate free markets from unearned wealth, clearing our minds to build a new and better

synthesis.

Many friends of the free market lend credence to the view that capitalism is merciless and predatory. They would have us resign ourselves to its failures as the price we must pay for an otherwise efficient, dynamic economy that raises living standards for many people. "Greed is good," recites actor Michael Douglas in *Wall Street*, epitomizing the message preached by dominant economic gurus of the avaricious '80s.

Workmanship turns to predation, and self-interest to greed when, in Veblen's term, there are "runs of free income" available.

"... being in no way related quantitatively to a person's workmanlike powers or to his tangible performance, (this cupidity) has no 'saturation point.' ... Their passion for acquisition has driven them ... to an indefinitely extensible cupidity ... (for) more than their proportionate share of the soil; not because they were driven by a felt need of doing more than their fair share of work ... but with a view to cornering something more than their proportion of the community's indispensable means of life and so getting ... something for nothing in allowing their holdings to be turned to account."¹

Veblen was writing about land, the prime source of unearned income and gains. The ambitious writer can produce a new book to share with thousands; the builder raise a new house to increase the total stock. The ambitious land speculator, however, only acquires more land by taking it from others. Supply being fixed, there is no other source, hence the link of greed and land acquisition, and the link of this greed and market power. Those who have land can extract fortunes without (as landowners) giving anything in return.

The greed that concentrates market control will restrain economic growth overall. Even those who deny this happens at home see it clearly when it is called OPEC. Greed also unequalizes the distribution of any given amount of wealth, which leads to an indirect obstacle to employment and production. The political system cannot deny help to the losers, even in ancient monarchies and ever so much more so in today's democracies. That means taxation, whose burden may further shackle production and create more losers, in a vicious circle.

The tragedy for capitalism is that the role of unearned wealth is kept invisible. That was one of the goals of J.B. Clark and others, and the achievement of the "neoclassical" economics they sired. For a century many scholars have succeeded in distorting the concepts and data needed to lay bare the problem. In the face of vested interest and blinkered scholarship, statesmen miss the main point and formulate wrong policies. Capitalist philosophers have to rely on the collapse of Marxism for a brief interlude of smug self-congratulation before turning back to our real world of worsening social problems.

Public debate in the United States, when President George Bush urged cutting taxes on capital

¹Thorstein Veblen, 1923. *Absentee Ownership*. New York: B.W. Heusch Inc., pp. 139-40.

gains, should have exposed the contradictions. He claimed this tax cut would leave greater profits to promote capital formation and the flow of new investment. In truth, most of the gains go to landowners who take without giving, who milk without feeding.

Yet debate in the salons of Washington and the pages of leading economics journals contained hardly a whiff of this analysis. The mighty American economy was allegedly pointed one way but actually steered another, a deceptive, destructive performance. Where did things start going wrong?

Policymakers in the Progressive Era, when income taxation was young, well understood the difference of earned and unearned income. They set out to tax the latter and spare the former—that's what the 16th Amendment was all about. The early principles of income taxation have been progressively subverted, reshaping income taxation to the present destructive travesty. We may yet reform the tax to fulfill its early mission of meliorating, and so saving, capitalism.