HOW I MADE $1,000,000 IN CHICAGO REAL ESTATE:
I STOLE IT FROM YOU

A presentation which is also the first session of the Progress & Poverty course.

Draft version Sept 17 2009

THE THEFT
Staff: Suppose a man comes up to you and politely says, I am going to steal part of your income, maybe 25%, but you'll never know exactly how much, for the rest of your life. And in the process, I am going to make it impossible for you and others to ever eliminate poverty, or solve the many problems that follow from it. And while there will be economic opportunity for some people, I will make sure that many people never have the opportunity to earn a decent living. And I am going to do this in a perfectly legal way, so going to the police or the FBI won't do you any good.

And, he continues, I am not from the IRS, nor any other government agency. I operate independently for my own benefit. Thousands of other people are doing the same thing as I am.

What would you do?

I think you should do exactly what you just did, come to the Henry George School to find out who this person is and how he and his fellows can be stopped.

These men-- and women-- operate in our society every day. Here's one of them. George, can you explain what you did?

G Menninger: Take a look at this building. I bought it in 1981 and sold it in 2006. I made a profit. A big profit. And I sold it to somebody who did not want it. Can anyone suggest why someone who did not want the building would buy it for big bucks?

Yes, what they wanted was the land, the location. It happens in every town, every neighborhood. Locations tend to become more valuable (thought not all locations, not every year).

Of course, during the 25 years I had it, my tenants paid me every month, enough to cover the mortgage, maintenance and taxes, so it never really cost me anything to own the land. When I sold it, my profit on an investment of less than $50,000 was about $1.7 million. I took it and I'm living on it (and the profits from other transactions.)

The average worker in Chicago might work a lifetime and not make this much money. But I did. Without working. Other people work to satisfy my needs and desires. I eat, I live in a house, I drive a car, I have everything I need and want, and I never worked for it.

You might be able to do this too, if you're young enough, smart enough, patient enough, and lucky enough. But I'm not here to explain how to do it. I'm here to help you

-- understand that this is theft, very much like slavery would be theft;
-- that it continues to frustrate efforts to improve our community;
-- how it can be stopped, if there is a will to stop it; and

-- the effects stopping it would have on opportunity for ordinary people.

WHY LAND HAS VALUE

Staff: Does anyone have any idea what land is worth in the Chicago loop? North Michigan Avenue? In a fashionable neighborhood such as the Gold Coast or Lincoln Park? How about in the middle of Nevada? How about in Englewood?

Why are these values different?

In considering land value, it's helpful to use the concept of land rent, how much the land is worth per month. Sometimes land really is rented, but even when it's not, the land rent is an implicit part of the sales price or the rent paid for a building or apartment.

For any parcel of land, the land rent really represents the advantages over other land. Let's take a couple of examples.

A THEORETICAL EXAMPLE

Ford Heights is perhaps the poorest community in the Chicago area. The vast majority of people there are renters; and there are virtually no jobs in the village. (If there are any landlords living in the village, they're probably not poor, so we aren't directly concerned with helping them.)

To keep our example simple, suppose every family in Ford Heights has an income of $1,000/month. And assume that every family pays $500/month for rent, leaving $500 for everything else. Neighboring communities are about the same, income of $1,000 and rent of $500.

G. Menninger: Suppose I am a philanthropist, and I want to do something for these poor people. I will give every family a voucher good for $400/month at grocery stores. But people living elsewhere aren't eligible. Now if you are a poor person living outside Ford Heights, where would you like to move? What will happen to rents in Ford Heights? How high could they go?

I see that my free groceries project isn't really making the people much better off. So I set up a medical clinic, pay a staff, and anyone who lives in Ford Heights gets free quality medical care. Let us suppose that the value of this care would be, on average, $400/month/family. Again, if you are a poor person living outside the Village, where would you like to move? So what again will happen to rents in Ford Heights?

You probably don't think of it, but if you rent or buy a house you're really getting two different things.
(1) the house
(2) the land, or site, that it occupies
In our Ford Heights example, houses are about the same inside and outside the Village. It's the site, the location within Ford Heights, that brings extra value. So it's the rent of *land* that's increasing; the rent of the house doesn't change.

Of course if I am very wealthy, I can expand my project beyond Ford Heights, to all the neighboring places, even the entire county, state, or nation, but landowners would still pocket most of the gain, as we shall see.

	Outside Ford Hts	Within Ford Heights		
		base case	free food	free medical care
Average income	$1,000	$1,000	$1,000	$1,000
Value of free food	$0	$0	$400	$400
Value of free med	$0	$0	$0	$400
Real income	$1,000	$1,000	$1,400	$1,800
Rent	$500	$500	$900	$1,300
Income after rent	$500	$500	$500	$500

AN ACTUAL HISTORICAL EXAMPLE

Staff: Here's a second, shorter example. It isn't mine, it's from a speech by Winston Churchill[1]

There was a toll bridge across the Thames in London, and the working people who lived on the south side of the river paid half a penny each time they crossed the bridge to the north side, where most of the jobs were located. This was six pence per week, a substantial part of the wage in that time. The public conscience was aroused, a public authority bought the bridge and eliminated the toll. What do you think happened to the rents on the south side? They went up by, yes, about six pence per week.

And, as we realize land and buildings are not the same, was that an increase on the house rent or the land rent? Suppose you owned a vacant lot in the residential district south of that bridge, where a house could be built. Do you think the value of that lot would increase?

G. Menninger: Again, back to the land I bought and sold, why does it have value? Partly because it is in a community where many people live and work, and partly because your tax money-- sales tax, income tax, all the taxes-- pays for police, schools, fire protection, garbage pickup, transit, street maintenance, parks,-- even bridges, over the Chicago River at least-- and lots of other things that make my land more desirable. Thank you for enriching me.

If you think this is fair, that you paid to enrich me for doing nothing, I have no response. But I think, and a lot of people think, it's not fair. We will use some simple economic concepts to explain how it could be remedied, in a way that benefits you and me both. These concepts are from classical economics, also known as political economy. If you're familiar with Adam Smith, John Stuart Mill, David Ricardo, or Henry George, these will be familiar ideas though you might not have seen them applied this way.

TWO QUESTIONS TO CONSIDER FIRST

But before we start, two questions need to be considered:

1 The People's Rights, 1909. http://cooperativeindividualism.org/churchill_peoples_rights.html

First, if these ideas are so great, how come they aren't already accepted and widely used? The answer is attributed to Einstein: “Common sense is the set of prejudices we learn by the age of about 18.” People usually accept the ideas of the people they grow up with and live their lives with. One of the best examples, from American history, is the pre-civil-war southerners who had absolutely no reservation about slavery. Even in the north, to be an abolitionist was to be a dangerous radical. Today, among Americans, there is no question that slavery is wrong, but people did not see it then.

Second question is, when we explain George's proposal, is it fair? Of course we think it is, but that doesn't mean it's perfect. We need to compare it to the current situation and trends.

My father was born in 1891. When he started working there were almost no taxes—certainly no federal income tax and no state sales tax. By the time I started working, there was a federal income tax and a state sales tax of 2%, still no state income tax. Now my children are working, and they pay federal income tax, state income tax, state and local sales taxes totalling over 10%, and many other taxes on electricity, phone service, natural gas, rental cars, and so on and so on.

Staff: So the trend for taxes on working people is not encouraging, one of the reasons it is getting more difficult to make a living. What is the “right” amount of tax for a working person to pay? Henry George would say “nothing,” and that is how his proposal works, as we shall see.

And to look at fairness another way, suppose I need to hire twenty people, all to do exactly the same job. The first two people I hire, I pay $40/hour. I keep paying them that amount, but as I hire more people, the new hires are paid progressively less, until the 18th and 19th each get just the minimum wage. They all work just as hard, and produce just as much, but how much you earn depends on when you were hired. Is that fair? It's the way the real economy works today, and Henry George's proposal is an effective solution. We shall say more on this soon.

CLASSICAL ECONOMICS

Classical economics recognizes three factors of production. A factor is something that contributes to a result, and these three things are usually required for the production of wealth. “Wealth” can be thought of as “things people need or want.”

The first factor can be called land/earth/opportunity. The second is labor, which represents human effort in production. And the third is capital, which is wealth used to produce more wealth. (capital is not the same as money, but rather such things as tools, machines, partially-completed products, and inventory). And, just three more terms, each factor of production receives a portion of the wealth produced. We call these land rent, wages, and, interest. Again, this is not the same as interest paid on a loan or bank account, as we shall see.

[chart]

SHIPWRECKED

G. Menninger: To illustrate this simple model, let's consider a shipwreck. One person survives, she washes up on the shore of an uninhabited island. She does not expect to be rescued any time soon, so she will have to survive on this island. She sits down on a log to rest. What does she have to do in order to survive?

She will not find a furnished house with a full refrigerator on this island. She is going to have to work.

So she is-- labor. She will work to produce wealth, things she needs and wants, food, some sort of shelter, clothing after a while. What is the land in this example?

The island is the land, the opportunity. She will use what nature put on the island to produce the wealth. We will suppose that this is not a desert island, it has some vegetation, fresh water, and at least part of it is above high tide. And we will suppose that there is a pool with fish. She like sushi so she will eat some fish.

It is difficult to catch a fish with your bare hands, but there are some vines on this island; she can weave a net from the vines and use it to catch fish. What is this net? Capital. Suppose at night she converts it into a hammock to sleep in. Then, at night, the net is not capital. Whether a thing is capital depends on how it is used.

Staff: It turns out there was another survivor, who drifted about for a bit but finally lands on this island. Now we have two people, we can start talking about an economy. The second survivor says, I would like to catch some fish too. May I use your net?

The first survivor might say “Yes, but I want one third the fish you catch with it.” It is agreed, and our second survivor catches 21 fish. Fourteen fish become his wages, and seven fish are given to the owner of the net, as interest.

Or suppose the first survivor says, “No, you may not use my net.” No. 2 has an alternative, he can make his own net.

At this point, we have wages and interest, but no rent. Unless the first survivor says, “This entire island belongs to me and you must pay rent,” and No. 2 accepts that.

LAND COMPARED TO CAPITAL

Two differences between land and capital:

(1) If no one gives or lends you capital, you can usually make your own. Not so with land.

(2) Capital is a product of labor so the producer is entitled to some reward, otherwise there will be no capital. Not so with land.

As this illustration makes clear, land need not be privately owned. In fact, throughout history, most societies most of the time did not have private land ownership. Native Americans did not; they farmed, and you may have been entitled to the produce you planted, but after your harvest you had no further rights to that land. And native Americans also had no extremes of wealth and poverty.

G. Menninger: Land is man's one and only opportunity. What I mean by justice is: We are not all equal, but we all deserve an equal chance. And that means we all have an equal right to land.

Two special notes here:

> (1) Most corporations collect both interest and rent, and pay both interest and rent. The concept of corporate “profits” is an accounting term, and can be manipulated. Profits may be some combination of rent, interest, and even wages.

(2) Many individual people can receive more than one kind of income. If you own an apartment building you can get rent for the land it is on, interest for the use of the building itself (which is capital), and wages for the services you provide if you maintain it yourself.

LAND RENT, POVERTY, AND OPPORTUNITY

[draw the pie]

Part of the reason poverty persists is that of the wealth produced, the share going to landowners does not go to the people who produce the wealth. This reduces wages, making workers poorer.

But there is a much more serious way in which the private collection of land rent, by people like me, limits opportunity and prevents the elimination of poverty. To explain it, let's look at what determines rent.

A KEY ECONOMIC PRINCIPLE: THE LAW OF RENT

Staff: Here is a ballpoint pen, and there is a videocamera. Which is worth more? Why? Of course, it takes much more labor to make a videocamera than a ballpoint pen, so it costs more. If this was not the case, videocameras and pens would soon be more or less the same price.

But land is not produced by labor, and yet it certainly has a cost. And land is more valuable on North Michigan Avenue than in rural downstate. The “law of rent” is the economic principle that explains the cost of land. For convenience, we will look at land rent, which we all agree is closely related to land value. We will also make some simplifying assumptions:

(1) Initially, the land is unowned and uninhabited, and available to be claimed by anybody who arrives. If there were previous inhabitants, they are gone.
(2) Initially, everybody is planning to use the land for farming, growing the same sorts of things.
(3) Some of the land has more productive potential than other land, and the people arriving are sophisticated enough to see which land is good and which land is not so good. The numbers in the squares indicate how many bushels per acre would be produced by the average person, working the customary amount of time with the customary equipment, in each area.
(4) People will arrive one at a time, and folks are generally peaceable and won't “steal” someone else's land.
(5) The only thing that matters to the settlers is the productive potential of the land. They don't care about, or don't have, scenic views, helpful neighbors, distance to water, etc.
(6) Recognizing that capital is really just a stored form of labor, we treat wages and interest together.
(7) In our simple model, landowners can profit by renting out their land, but they do not sell land.

This is more or less similar to the way land was privatized in Illinois a couple hundred years ago. Once we understand the simple model, it's easy to add complexities to better represent the real world of that time, and the real world of today.

[go thru the routine of how rent, wages and interest change as the margin moves down. Show the effect of speculation on wages & interest. Show that improved productivity doesn't raise wages and interest except to the extent it affects productivity at the margin. Discover oil or gold. Build a city.]

Remember our example of salaries based not on what you do, but when you started? Isn't this the same? Some get much more than others, due not to anything they have done, but by, essentially, luck.

HOW THE LAW OF RENT APPLIES

G. Menninger: Now, let's look at America. In the 1780s Thomas Jefferson wrote that there were few beggars in America. Why? Because people (if they were male and free) could get good land cheap, just beyond civilization. If you were an employer, and you reduced wages, what would your workers do? So wages had to be high enough to keep them from moving to the frontier. (And you don't need to be a farmer to move to the frontier, where skilled workers such as blacksmiths and teachers were also needed.)

In a later example that Henry George used, why were wages high in San Francisco in 1849? What happened in California that year? Gold had been discovered, anyone who wanted could, with minimal equipment, pan or dig for gold. Everyone expected to get rich, and many did. The land was common, available to all. Why would anyone work for low wages in San Francisco?

It was only around 1873[2] that the word "unemployment" was used by Americans to mean "unable to find work." With free land dwindling, landless workers had no alternative to accepting whatever jobs were offered.

How does that relate to our modern urban society? Henry George was writing in an age of growing cities, and his description (taken here from a modernized version) gives us perspective.

[the savannah]

How does this relate to us today? Few of us are farmers, but all of us need land. We need land to live on, whether in a suburban house or a high-rise apartment. We need land to produce, whether in an office, store, or factory. Like the soil, all the forms of energy we use-- petroleum, coal, natural gas, uranium ore, even wind and sun-- are land, gifts of nature, not a product of labor. Land rent is a big piece of today's economy.

Staff: And certainly we see speculation holding land out of use. Right across the street is a surface parking lot, in the Chicago loop half a block from Michigan Avenue. More surface parking lots are a block away. Is this the most productive use of the land? Of course not. If the land was developed at its proper density-- maybe an office building, or retail stores, or classrooms, whatever-- how many more jobs would exist, how much time and energy would be saved in reduced commuting time, ultimately how much higher would wages be? A minimal amount for each parcel.

FUNDING PUBLIC SERVICES

The community-- the neighborhood, the city, the nation-- has needs, for public services which are customarily provided by government. We can debate just what those needs are, but I think we all agree that there are needs and that it takes wealth-- represented by money-- to pay for them. The community also generates wealth, as the passage describes, more wealth and services, and a higher standard of living, are possible in communities than in lightly-populated areas. This community product can be measured by land rent.

G. Menninger: Today, most of the community-generated wealth is taken by private land owners, most of our community services are paid for by taxes on labor and capital.

---

2 "Until the Late 1800s, U. S. Had Never Known Unemployment Woes," *Wall Street Journal* December 3 2003, page B1

Producer of wealth	individual (wages & interest)	community (rent)
Consumer of wealth	individual	community

What Henry George says is, why not let the wealth produced by the community be used to pay for the services the community requires? And let those who produce wealth keep what they produce.

Producer of wealth	individual (wages & interest)	community (rent)
Consumer of wealth	individual	community

HENRY GEORGE'S "REMEDY"
Operationally, how do we do this?

First, we abolish all the taxes on productive work and the products of work. All taxes on wages, payroll taxes, sales and consumption taxes of all kinds, taxes on houses and factories and other buildings. What you produce is *yours*.

Second, we collect the rent for the community. Operationally, this can be done by adjusting the existing real estate tax, or in other ways.

The advantages: More jobs at higher wages, lower taxes, lower cost of living, a fairer society.

The disadvantages: Some people are reluctant to accept any change.

The reform is "simple but not easy."

THE EVIDENCE
Staff: Aspects of George's remedy have been applied in various times and places. Many research papers and at least two recent books[3] have been written about this experience. To take two examples:

(1) In Hong Kong under British rule, land was not privately owned, but leased by the government. Revenue was sufficient that the average worker didn't pay any tax.

(2) In a number of declining Pennsylvania cities, an increase in the amount of land rent collected led to a subsequent increase in the amount of construction activity.

IN CONCLUSION
G. Menninger: But the most important evidence is in your own mind. Think about what you've heard here today. Does it make sense to you? We have had to omit a lot of details, and I encourage you to take, now or in the future, our *Progress & Poverty* course which explores this in much more depth.

Thanks again for enriching me. If you want to enrich me some more, ignore what we've said, and I will

3 *Land Value Taxation Around the World* (Schalkenbach 2001; and *Land Value Taxation: Theory, Evidence, and Practice* (Lincoln Institute, 2009)

be happy to collect more of the wealth that you are entitled to.