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ABSTRACT. *Reflecting the Progressive Era's reform agenda Simon Patten (1852–1922) argued that freeing markets from one source of economic rent (by taxing land rent) would merely leave the surplus to be taken by other monopolists and rent extractors (railroads, Wall Street trusts, and basic privatized utilities). To prevent unearned income (economic rent) from adding to the economy's cost of living and doing business, potentially rent-yielding infrastructure should be kept in the public domain as a "fourth factor of production." Instead of rentiers making a profit by charging access fees and user fees, the return to public investment should take the form of reducing the economy's overall price structure.*

Along with Edmund James and Richard T. Ely, Simon Patten studied in Germany in the late 1870s. As in America, Germany's national interest called for an alternative economic policy—and hence, a supportive body of economic theory—from that of British free-trade orthodoxy, which left public-sector investment out of account. "I became imbued with the German view," he wrote, "and came home hoping to help in the transformation of American civilization from an English to a German basis" (Patten 1912, in 1924: 273).

The German Historical School's focus on national differences in political and economic institutions reflected its concern with state leadership in protecting industry and pioneering social welfare policy by enacting labor laws such as old-age pensions. Patten saw Germany's creation of a public railroad network in particular as increasing its competitive industrial power

along similar lines to those that protectionists in the United States were following. National price structures were being shaped not merely by wages, profit, and interest rates, but also by public spending and tax policies.

Returning to the United States, Patten saw a mixed economy shaped by public investment in transportation, education and other infrastructure, protective tariffs, and subsidies. His friend James was appointed senior professor at America's first business school, the Wharton School of Finance and Economy at the University of Pennsylvania, in 1883, a year after it started classes.

In 1885, James, Ely, and Patten took the lead in founding the American Economic Association. Three years later James helped bring Patten onto the Wharton faculty as its first professor of economics, a chair Patten held until 1917. (I summarize Patten's life and major writings in Hudson 2010.) From his defense of protectionist trade policy to his advocacy of social reform, Patten recognized that national economies were at different stages.

America differed from England, as did Germany and other countries confronting British industrial competition. Free-trade policy was not appropriate for conditions that called for steering economic evolution along the most productive lines. And what British economists treated as universal actually reflected its class structure, especially its hereditary groundrent stemming from the Norman invasion. Free-trade economists attributed America's high wage levels to the nation's vast backwoods of available land on which to settle as an alternative to working in factories. Like other protectionists, Patten found this explanation insufficient.

American industrial labor had to be sufficiently productive to sustain higher living standards. This required investment in capital, which in turn required protective tariffs and public infrastructure investment. Patten recognized that rising productivity, public investment, and wage levels went together. That is what enabled well-fed, well-trained, and well-housed American labor to undersell "pauper labor." American free traders who followed the lead of British economists in urging governments to stand aside bought the idea that market forces by themselves would produce the most efficient outcomes. But what are markets, reformers asked, if not carefully constructed arrangements shaped by tax laws, land and property tenure, government subsidies and price regulation, educational systems, and infrastructure? Would not a market without regulation or public services become "free" for predators?

The institutional and sociological economists who emerged from the American protectionist

tradition and German Historical School were almost alone in retaining from classical political economic thought the concept of economic rent (the excess of market price over intrinsic cost-value) as unearned income. Defenders of property and opponents of tax reform found this focus on rentier revenue disturbing, above all its application to land ownership, and the monopolies and trusts created by Wall Street. These vested interests applauded the free-market marginalists who took property relations for granted, and especially endorsed John Bates Clark's rationalization of property income as "earned."

While extending economic analysis along lines that later would be called institutional, Patten retained the classical definition of rent as unearned income—the excess of market price over intrinsic cost. Economic rent taken by landlords, monopolists, and financial institutions has no counterpart in the technological requirements of production, but stems from legal and historical privileges that privatize the free gifts of nature or permit monopolistic power to charge access fees over cost for the use of basic infrastructure. Patten believed that economies should minimize the cost of living and doing business by becoming as rent-free as possible, socializing monopolies outright, or at least taxing land, mining, and other natural resources, and regulating prices to minimize unnecessary rentier charges.

Rent Theory and the Crisis of Classical Political Economy

Patten recalled that the generation of American economists who studied in Germany in the 1870s was taught that John Stuart Mill's 1848 Principles of Political Economy was the high-water mark of classical thought. But Mill's reformist philosophy had been overtaken by more activist schools, and turned out to be "not a goal but a half-way house" between classical laissez-faire and the emerging epoch of class conflict. Mill was "a thinker becoming a socialist without seeing what the change really meant," Patten concluded: "The Nineteenth Century epoch ends not with the theories of Mill but with the more logical systems of Karl Marx and Henry George (Patten 1912, in 1924: 274; also see Patten 1899: 339).

The rise of socialist reformers in the wake of Europe's 1848 revolutions defined labor/capital relations as exploitative and called for nationalization of the means of production. As Patten observed, "If this new group of thinkers called themselves sociologists or historians they might be disregarded." But the social reformers "openly claim to be economists, and the worst of the matter is, they have . . . the mass of the older economists on their side. Nothing pleases a socialist or a single taxer better than to quote authorities and to use the well-known economic theories to prove his case (Patten 1908a, in 1924: 219).

Meanwhile, the analysis of economic rent paid to owners of land, mineral resources, and natural monopolies—using the labor theory of value to isolate such rent as "empty" pricing that

did not reflect production cost—flowered into a political movement to tax or nationalize and socialize land and monopolies outright. The vested property interests felt duly threatened. The new generation of economists, friendlier to the vested interests, "soon realized that their favorite authors were not so perfect as they supposed, and that economic doctrine must be recast" to exclude logic that implied an exploitative character of the "unearned increment" that landowners obtained in the form of rent and rising property prices, and even industrial profit as surplus value (employing labor to sell its products at as large a markup as possible).

Reacting to the policies of Marx and Henry George that urged nationalization or full taxation of land and natural resources, a post-classical orthodoxy arose to divert attention away from the analysis of economic rent as unearned income (prices and income without cost value). Clark in America and a marginal utility school in Europe tried to base their view of the economic system on consumer psychology, while treating all income as reflecting—by definition—the recipient's contribution to production. The result was a circular reasoning to confirm their desired outcome and starting viewpoint: If all income was "earned," there was no such thing as a free lunch. Wages were rising, paid out of productivity gains. Describing America as reflecting the dynamic of future evolution to a "pleasure surplus" economy, Patten showed how a growing surplus was available not just to landlords and owners of capital as in Ricardian theory, but also to workers in the form of rising wages and living standards. This means that rentier income is taken at the expense of labor's high wage levels as well as industrial profits.

David Ricardo juxtaposed "profits and wages, or profits and rent, but never rent and wages. If he had broken away from his concrete thinking enough to contrast wages and rent, he would have forestalled Henry George, since the latter writer has nothing new of theoretical importance except this contrast neglected by Ricardo and his followers" (Patten 1892, in 1924: 153). To Ricardo, writing at a time and place when it seemed natural to assume subsistence wage levels, the major class conflict was between landlords and industrial employers.

Ricardo described economic rent as rising for owners of the most fertile soils as diminishing returns pushed up crop prices at the margin of cultivation where land was least fertile. This forced up subsistence wages. The higher cost of living was paid to landlords, whose income rose at the expense of industrial profits. To avoid rising food prices, Ricardo argued that Britain should import cheaper grain from abroad—and indeed it repealed its protectionist Corn Laws in 1846. "Ricardian socialists" from James Mill and John Stuart Mill to Ferdinand Lassalle in Germany and Henry George in America radicalized the analysis of groundrent.

Land prices and rents rose not because of efforts made by landowners themselves, but because of economy-wide forces (general prosperity) and public investment that increased site

values. This became the socialist argument for nationalizing the land, or at least its rental income. Arguing that not all market prices and incomes were earned fairly or reflected social use value, "institutional" economists such as John Commons and Thorstein Veblen emerged around the turn of the 20th century to analyze "unearned" wealth, especially that of the emerging monopolies and trusts. Social and fiscal reforms were needed to steer prices and the distribution of income to maximize economic welfare.

Combining evolutionary analysis with the evangelism of economic reform, they advocated public policies to promote a more productive and fairer economic future for everyone. The guiding idea of economic fairness—and also of competitive power—was to minimize unearned income, that is, income without a counterpart in technologically necessary costs of production.

The Democratization of Land Rent—On Credit, with Increasing Debt Leveraging

Rentier income was a class phenomenon in Britain and other European countries. Most groundrent was still monopolized by the landed aristocracy, the heirs to the Norman conquerors.

Economists from Ricardo through Mill analyzed how economic rent and land prices rose at the expense of industrial employers. In the years before the word "socialism" took on Marxist connotations dealing mainly with labor and with the outright nationalization of property, "Ricardian socialists" described groundrent and rising land prices as accruing to landlords in the form of what Mill termed an "unearned increment"— unearned because the gain occurred without property owners having to expend any effort of their own. [1]

Higher prices for food, minerals, and the products of natural or artificial monopolies threatened to increase labor's cost of living (and hence, subsistence wage levels), eating into industrial profits and bringing investment and economic growth to a halt—all to benefit an idle landlord class. In contrast to Europe's hereditary landed aristocracies, land rent and interest recipients were not a specific class in the United States. Railroads and other monopolies were a more pressing concern. Their extortionate pricing prompted the government to enact the Sherman Anti-Trust Act and create the Interstate Commerce Commission to regulate railroad charges.

Patten wrote about economic rent in his critique of Ricardo in his 1890 *Economic Basis of Protection*, and provided a critique of Clark and George the following year. The thrust of his analysis was that minimizing economic rent would benefit labor, farmers, and small business as well as

capitalists. Rather than each type of income being associated with a distinct political class as in Britain (groundrent with a hereditary aristocracy), property ownership was becoming so widespread a phenomenon that most Americans received the economic rental value of their homes or farms, and most received interest as savers, as well as profits made by the emerging middle class of businessmen.

The older thought assumed that for each kind of income there was a social class which was interested in its defense. The social condition of England at the time economic theory was formulated favored this concept. The aristocracy held the land, the so-called middle or industrial class owned the capital, while the great mass of unskilled and politically unprotected laborers did the work. The essence of the Ricardian economics was an opposition to the aristocratic landlords, and it succeeded so well that an imputation of being unearned was put up on their income. In America, however, while we have rent, we have no landlord class. The income from rent and interest is so diffused that all income-receivers form one class. . . . Profit holders blend with the holders of rent and interest and think of themselves as a social unit. All get profits, rent and interest in their income . . . . (Patten 1908a, in 1924: 219)

Industrial protectionism, trade unionism, and bank credit enabled families to obtain farms or homes in cities with good public school systems. This led to a growing economy in which, "when families get $1,000 a year their income is derived more from monopoly, rent and interest than from mere wage-earning power. They own houses, they receive special rents from the position of local advantage they hold, they enjoy monopolies through their trade unions, and they derive great advantage from the municipal expenditures that give them water, health, sanitation and education. Their income is thus not pure wages, but a diffused income derived from many sources" (Patten 1908a, in 1924: 221).

This is why land taxation never was as popular in the United States as in Britain. Land remains the major asset in every economy today, followed by natural monopolies and subsoil minerals and fuels, and property ownership has been the major force shaping fiscal policy as well as politics. There is indeed a power elite composed of what Veblen called vested interests, but land ownership—especially housing—has been democratized. This has enabled absentee owners and speculators to represent their interests as synonymous with that of small homeowners in campaigning for property tax relief. And behind them stand the bankers — some 70 percent of bank loans are mortgages, absorbing a rising share of property's income via interest charges.

The Objective of Minimizing Economic Rent Across the Board

Classical economists from John Locke through Adam Smith, Ricardo, and Mill defined value ultimately in terms of the expenditure of labor (including that embodied in the production of capital goods and other inputs). To them, bidding up property prices on credit did not reflect underlying value. Nor did stock watering, which occurred when financiers and other insiders issued bonds to themselves, counting the interest charges on these securities as part of the cost of production.

Classical economists described interest payments in general as an element of market price in excess of intrinsic value, a financial form of rentier overhead. The Progressive reform movement in America accordingly aimed to bring prices in line with production costs to reflect this intrinsic value. This meant developing a policy to minimize economic rent and "fictitious" or "watered costs" imposed by monopolies and finance—charges that, as Patten put it, entered into prices beyond "the doctrine of physical valuation," his term for the labor theory of value.

Although Ricardo (followed by George) warned that groundrent threatened to absorb the entire economic surplus, Patten pointed out that other monopolies also vied for it, headed by the railroads seeking to appropriate agricultural rents. Frank Norris's novel The Octopus (1901) told how the railroad monopoly exploited farmers, and Gustavus Myers' History of the Great American Fortunes (1907–1909) exposed its political insider dealings. To regulate railroad rates "so that the cost of production shall fix prices" (Patten 1908b, in 1924: 253), the Interstate Commerce Commission was founded to prevent railroads from exploiting farmers, consumers, and industrialists by incorporating unnecessary financial and kindred rentier costs into their transport charges.

It is, therefore, a popular error to suppose that the rent of land absorbs the whole of this surplus. According to the Ricardian theory of distribution, this would be so, but this theory gives an undue emphasis to land . . . the surplus, however, may be absorbed in many ways . . . Our railroads are now getting a large share of this surplus. As the owners of farms are separated from the market of their produce by long distances, they must make use of our railroad system to transport their grain. Any increase in the rates of transportation, therefore, will act as a reduction of rent, and if the railroad system of our country has its stock largely watered, it will reduce the value and rent of lands, and in this way a large portion of the surplus will go to the owners of railroads, rather than to the owners of land. (Patten 1891: 361)

To move against just one monopoly, such as land ownership, was not enough for Patten. "It is often said that the way to avoid socialism is to control particular prices such as railroad rates or tariff schedules; but this control will not help the public so long as other forms of monopoly

remain undisturbed" [2] (Patten 1908b, in 1924: 255). Revenue freed from one monopoly is available for others to take.

The application of the principle of physical valuation to railroads does not mean any advantage to the public so long as the same principle is not applied to farms and city lots. Low railroad rates mean a high value of western farms with higher rents and more congestion of population in eastern cities. Should the value of western farms go up to $150 an acre because of lower rates, it does not mean that western farm laborers will get more wages, or that farm produce will sell at a lower price in eastern cities. Higher land values will push the pressure of population into cities more rapidly than before and the pressure to lower wages will be strengthened. These conditions will make apparent the advantage of extending to land the same principle of physical valuation that landholders now want to have applied to railroad property and to protected industries. (Patten 1908b, in 1924: 254)

Patten criticized George's Single Tax for leaving monopolies besides land intact. Unless economic rent were taxed across the board, the rent rescued from one party's grasp would be taken by others: "a limited application of the [land tax] principle . . . merely lowers the value of one form of monopoly and raises that of some other. Farms go down in value as railroad rates go up. Land values in cities go up as tariffs go down" (Patten 1908b, in 1924: 255). Further, taxing the land's rental value "would cause the watered costs of the farms and city property to shrink to a lower point than would the values of railroads" (Patten 1908b, in 1924: 254). Patten thought that George was shortsighted by supposing "that we can secure all the surplus if we would only seize the rent of land. We might in this way get only a small portion of it. The rent of farm land seems to decrease, relatively at least, with the advance in civilization, and hence a larger portion of the surplus is absorbed in other ways" (Patten 1891: 362; Patten also made this critique in his "Principles of Rational Taxation").

Whereas George wanted to tax groundrent at market rates, Patten wanted to minimize economic rent. "We want a low price of food and not a large public revenue from land." The aim was to minimize rent and prices, not tax the maximum that could be extracted. The government should be a rent minimizer, not a rent maximizer that allows landlords (or itself as infrastructure operator) charging as much as the market would bear. Patten recognized that soil differences would diminish as agriculture became industrialized, and that rising farm productivity would make food prices "so low that the unearned increment will be unworthy of notice, and no one will care to disturb land-tenures to secure so small a sum" (Patten 1891: 369).

Transportation investment would lower the rent-of-location, which was more important than soil

fertility, given America's large land mass. To be sure, taxing the land's groundrent would leave less for railroads to siphon off. Every trust, or combination, therefore tends to transfer a considerable share of the surplus or unearned increment from the owners of land to the owners of other monopolies.

Patten proposed that the way to prevent rent seeking was to apply "the doctrine of cost prices, the physical valuation of property and the control of prices by the state" across the board, under the principle of eminent domain. Partial cures would be ineffective because to permit the state "to control [only] some prices is to give it the power to favor special interests." (Patten 1908b, in 1924: 255).

Minimizing economic rent by controlling all prices was implicitly socialist, Patten recognized. Progressive reform should start with land and transportation infrastructure, followed by the mining trusts. "The kinds of property that are in the fewest hands will be those to which this principle will be first applied, and each other kind of property will be attacked in turn until the application of the principle is general" (Patten 1908b, in 1924: 255).

The Vested Interests Fight Back

Recipients of economic rent—the vested interests—sought to narrow the scope of economics so as not to go down this path, by promoting their own economic perspective. Instead of focusing on economic and social structures, the marginalist mainstream emerging in opposition to Progressive Era (and especially to socialist) reforms took the status quo for granted in their economic arguments, as a way of defending and promoting their conservative point of view without calling attention to their conservative position.

Clark led the break from the classical treatment of rentier income as overhead. In a series of papers on land rent and interest in 1890–1891 culminating in his 1899 Distribution of Wealth, he extended his earlier attack on socialist claims that labor was exploited. Everybody earned what they deserved, he argued, in proportion to their contribution to production. Hence, no exploitation existed. "It is the purpose of this work," he wrote in his introduction (Clark 1899: v), "to show that the distribution of the income of society is controlled by a natural law, and this law, if it worked without friction, would give to every agent of production the amount of wealth which that agent creates."

Whatever income or wealth was "unearned" was held to result from "market imperfections," subsequently called "imperfect competition." By definition these imperfections were political and

institutional, and their study was exiled to what became the academic subbasement of sociology. John Henry (1983, 1995: 84) traces the inspiration for Clark's marginal productivity explanation of income back to his early critiques from 1877–1889 opposing socialist theories of "the wage problem" [3] (also the view of Clark's son, John Maurice Clark).

The implication was that landlords and bankers are part of the production process, with rent and interest explained by marginal productivity theory. This was a bad analogy, Patten argued. It could be maintained only by treating rent-yielding assets as capital investment, conflating tangible industrial capital with all other assets. At issue was what constitutes the cost of production in terms of real value, as distinct from extractive rentier charges. "The defect of the reasoning of Professor Clark", Patten observed, was his failure to distinguish man made capital from property rights (Patten 1891: 363). [4]

Clark's so-called pragmatic approach conflated profits earned on industrial capital with land and monopoly rent stemming from legal ownership rights involving no real cost of production. Real estate owners, monopolists, and financial operators deem their income to be earned by their own efforts and outlays. After all, their argument goes, they bought their land and other property on mortgage, and stocks and bonds whose price reflected the capitalized value of real estate, so that financial and monopoly charges were, to them, an investment cost. The vested interests are happy that "The farmer thinks that land values depend on real costs" because he had to pay good money for his property, explained Patten, "and the city land speculator has the same opinion as to town lots" (Patten 1908b, in 1924: 254). This is the argument expressed by Clark in The Distribution of Wealth, conflating rentier income with wages earned in the production sector: "each workingman under a perfect competitive law gets what he produces, and thus . . . the ethical standard of wages is the standard that society tends to realize in fact" (Patten 1891: 363).

However, Patten pointed out, these outlays capitalize property rights and financial charges that are by no means intrinsic and inevitable. Wealth in the form of income-yielding assets is provided freely by nature as well as by labor, yet natural and artificial monopolies are legal property rights or institutions that do not require labor to create or maintain. To Clark, economic rent appeared not as an element of price without value or labor effort, but simply as a return on what investors spent on acquiring land—just another cost of doing business. "According to the economic data he presents," Patten wrote, "rent in the economic sense, if not wholly disregarded, at least receives no emphasis. Land seems to be a form of capital, its value like other property being due to the labor put upon it" (Patten 1891: 356).

In practice, rentier rights are legalized tollbooths to extract revenue that rightly should belong in

the public sector. Clark argued that labor receives its entire product. But Patten pointed out that if rentier and monopoly income was unearned, it had to be at the expense of earned income.

It seems to me that the doctrine of Professor Clark, if carried out logically, would deny that the laborers have any right to share in the natural resources of the country. . . . All the increase of wealth due to fertile fields or productive mines would be taken gradually from workmen with the growth of population, and given to more favored persons whose shares are not reduced by the use of poorer land. These privileged classes would then enjoy all the advantages due to better natural resources or to more productive instruments of other kinds. When it is said that the workingman under these conditions gets all he is worth to society, the term “society,” if analyzed, means only the more favored classes who are contrasted with the workmen. They pay each laborer only the utility of the last laborer to them, and get the whole produce of the nation minus this amount. (Patten 1891: 365f.)

Subsequent mainstream economics has followed precisely the tautological circular reasoning criticized by Patten, depicting rent, interest, and land-price gains as costs of production built into the way in which markets function. “Professor Clark has a skillful way of hiding land values by subserving them under the general concept of capital,” Patten observed, “but if the doctrine of physical valuation is once introduced the public will soon be educated to the evils of watered land values” (Patten 1908b, in 1924: 254) and railroad rates.

What has disappeared from today’s neoclassical (that is, postclassical) economics is the idea of unearned income. Any given distribution of income and property is rationalized without acknowledging that market prices and incomes may diverge from benefiting society as a whole. “Everyone thinks he earns what he gets,” Patten granted, “but he [the investor] keeps his accounts in such a way that he exaggerates his costs until they seem equal to his income. As he views it, he has no unearned income similar to the watered stocks of railroads or the high prices of protected industries” (Patten 1908b, in 1924: 254). Whatever is paid to rentiers is considered a bona fide cost, and hence has intrinsic value. Contrary to the classical distinctions between economic rent, interest, and profit, everyone’s income appears justified regardless of the form it takes.

Clark would have been called a natural theologian if he had written in Adam Smith’s day, for his class harmony message that economic forces give each income recipient his just reward was an evangelistic “gospel of peace [rather] than of grim struggle” (Patten 1908a, in 1924: 222). However, Patten concluded, the idea that whatever income people obtain reflects their contribution to production turns economic analysis into circular reasoning. The tautology does

not explain who gets the surplus, and indeed is ambivalent over whether there really is a surplus. “To whom it shall go depends upon the laws and usages of each nation. Our present laws allow a large part of it to go to the owners of natural resources” (Patten 1891: 366).

A core tenet of American institutionalism as a program of economic reform was the recognition that “Rent is obtained by owners of land, not as a right based on economic considerations, but as a premium given by society to secure progress out of a fund to which its claim is superior to that of any individual.” Land and monopoly rights are not real factors of production, but are claims for payments levied as access charges to land, credit, or basic needs. “The unearned increment is that which comes to individuals or to classes, not from industrial qualities which they use in production, but from the lack of supply of some needed article,” Patten explained. “Although the case of land is not the only example where there is an unearned increment, because the price of food is always more than its cost of production on the best land, yet it is the best example, and hence is the one in common use as an illustration” (Patten 1891: 356f.).

To Patten the classical aim of minimizing rentier charges remained a prime policy objective. “With the increase of our knowledge of the incidence of taxation,” he concluded his essay on the ethics of land tenure, “we can place its burden more completely upon those who profit by the increase of rent and other forms of unearned revenue” (Patten 1891: 370). Whereas Ricardo had sought to minimize agricultural fertility rents by importing cheaper crops from abroad, Patten sought to minimize the rent-of-location by public investment in transportation.

Like most of his fellow reformers, with the exception of George’s Single Taxers, he extended the analysis of economic rent to monopolies across the board.

Public Infrastructure as a Factor of Production

Neither Clark nor subsequent mainstream economists recognized public capital investment as contributing to an economic surplus or otherwise fit it into marginal productivity models. Government spending was deemed deadweight cost, as if it were for war making or other economically unproductive purposes. Public sector spending in excess of receipts was a deficit, without regard for investment in infrastructure for future progress. Yet such investment has been the largest category of capital investment in most economies down to the 1980s. Patten stands almost alone among economists in recognizing this as capital investment fitting into an overall model.

Patten’s analysis of public spending goes beyond economics as such into the political and

sociological realm. He described the transition to a "pleasure" economy of abundance as being led by a shift in government spending away from war making toward a better standard of living. In contrast to military levies, which were a pure burden to taxpayers, "in an industrial society the object of taxation is to increase industrial prosperity" [5] (Patten 1892, in 1924: 96) by lowering costs rather than leaving economic rents to be taken by private appropriators intent on maximizing access charges to their holdings.

How the U.S. government increased prosperity was by creating infrastructure in the form of canals and railroads, a postal service, and public education as a "fourth" factor of production alongside labor, land, and capital. Taxes would be "burdenless," according to Patten, if invested in public internal improvements, headed by transportation infrastructure. "The Erie Canal keeps down railroad rates, and takes from local producers in the East their rent of situation. Notice, for example, the fall in the price of [upstate New York] farms through western competition" by making low-priced crops available from Western farms. Likewise in the cities, public transport would minimize property prices (and hence economic rent) in the center relative to the outlying periphery [6] (Patten 1892, in 1924: 98).

Under a regime of "burdenless taxation" the return on public investment would not take the form of profit, but would aim at lowering the economy's overall price structure to "promote general prosperity." This meant that governments should operate natural monopolies directly, or at least regulate them. "Parks, sewers and schools improve the health and intelligence of all classes of producers, and thus enable them to produce more cheaply, and to compete more successfully in other markets." Patten concluded: "If the courts, post office, parks, gas and water works, street, river and harbor improvements, and other public works do not increase the prosperity of society they should not be conducted by the State. Like all private enterprises they should yield a surplus" for the overall economy, but not be treated as what today is called a profit center (Patten 1892, 98).

Little trace of Patten's concept survives in today's national income and product accounting. It would go against current free-market ideology to estimate the price saving of public over private infrastructure investment by calculating its capital cost, and estimating what normal charges would be added for interest, profits, dividends, other financial fees, and high executive salaries. What is important to recognize is that industrialists themselves advocated infrastructure investment, going back to Henry Clay's "American System" of internal improvements, protective tariffs, and a national bank early in the 19th century. And indeed, in almost every 20th-century economy, public infrastructure represents the largest capital investment, especially in third-world countries. Yet free-market models continue to treat public spending only as deadweight, and public budgets report such spending as part of the deficit, not as capital investment productive of any economic return, except for user fees.

Ostensibly in response to these models, public infrastructure investment has been sold off and privatized since the 1980s. As Patten showed, the relatively narrow scope of free market marginal productivity models applied only to private-sector industrial investment, not to public investment. (What would the "product" be?) The great virtue of Patten's analysis was to point out that the alternative was to promote a rentier "tollbooth" economy enabling private owners of infrastructure or other monopolies to charge much more than the "marginal product" being supplied.

The Theory of Economic Obsolescence

Patten recognized what Alfred Marshall called industrial quasi-rents, which Joseph Schumpeter subsequently portrayed as the mainspring of entrepreneurial capitalism. Marshall and Schumpeter viewed them as being earned for introducing cost-cutting innovation. The long-term effect of such innovation was to lower prices as emulators adopted the new, more productive technology, assuming that "The gains of monopoly are temporary, due to sudden increases of productive power" (Patten: 1908b, in 1924: 255).

Patten recognized that economic progress left laggards in its wake. His belief that knowledge is the key to economic development led him to infer that countries failing to upgrade their educational systems and technology would be left behind because uneducated and untrained people lost out as a result of the social changes that Patten accompanied progress. In his view, such individuals deserved rehabilitation in the form of public education and job training. "The state has always made use of the right to put special taxes on those who have special advantages, and it would only be a further extension of a well-organized principle, if the cost of improving the condition of the lower classes was placed upon those whose incomes grow because of social progress" (Patten 1891: 368).

A second inference was that the rising role of knowledge would cause income and wealth disparities. "After the state has settled its accounts with those who have lost through the changes due to social progress, it must look to the holders of the unearned increment, and to those who have special gains from other sources, for funds to pay these claims against it" (Patten 1891: 368). But most of all, Patten's theory of economic rent—especially as it applies to public infrastructure investment as lowering economy-wide costs of living and production—suggests that countries failing to go beyond the rentier form of society would suffer higher cost structures and hence lose their competitive edge. And to the extent that monopoly privileges are sold on credit, interest charges are built into the seeming "cost of production" of essential services. Rent-seeking and financial practices thus might make entire national economies obsolete, so that the most rent-free economies would emerge dominant.

This was the starting point of what may be thought of as enlightened American industrial capitalism—which aimed at becoming the world's most rent-free economy.

The Aftermath

"We have arrived at a point in the development of the social sciences where we cannot let one another alone," Patten told the 1894 American Economic Association (AEA) meetings. But the "cleft between the economic and sociological camps" had widened to such a degree that economists were ignoring the institutional environment—the political element of classical political economy. To help overcome this situation, E. R. A. Seligman acknowledged that Patten taught and inspired "more of the younger scholars in the United States than any other individual" (Fox 1967: 146f). He was an early mentor of the social work profession, and when the American Sociological Society (ASS) was founded at the 1905 meeting of the AEA, six of its 36 founding members had taken their PhDs under him.

The ASS was formed to extend economic analysis to include the transformation (and hence, reform) of society's institutions of finance and property — and in response to the fact that the most socially aware economists were leaving the discipline as it was taken over by narrow constructionists who excluded the study of public policy-making from scientific status quo economics (Mitchell 1967). Rather than seeking "universals" as if this would give the badge of scientific method to economics, and rather than seeking a universal "technological" or material basis for explaining economic growth, Patten recognized that institutional practices were what defined national economies—their laws, their mode of handling monopolies and the phenomenon of economic rent, and their banking and credit practices — what today is termed the FIRE sector, finance, insurance, and real estate. Yet it is precisely the FIRE sector that subsequent "free market" economics has neglected.

Patten "was not afraid to break down the barriers between his science and others and to write about ethics, psychology, education, sociology, religion, and biology in the manner philosophers used before the great specializing trend of the nineteenth century began" (Tugwell 1923: 154). Patten "prophesied, before others, the success of feminism and prohibition, the success of economic federalism, changes in consumption habits . . . the general rise in living levels, [and] the future programs of taxation," observed his student Rexford Tugwell (Tugwell 1923: 188), citing Clark's remark "that Patten, at one time or another, anticipated all the later developments in economics, but that he worked none of them through" (Tugwell 1923: 186).

Much to our loss, Patten never formed a "school." His approach was too wide-ranging and

pan-disciplinary to synthesize in a Principles of Economics text. In contrast to the simplified view of current mainstream economics in which rent and free lunches, real estate and financial bubbles are portrayed as anomalies or "market imperfections," Patten's institutional economics retains a more realistic and socially complex perspective. But reactionary response by the vested interests to the progressive conclusions of institutional and sociological economics re-defined the criterion of academic economics to be simplicity and an internal consistency of assumptions, without much regard for their conformity to reality (Hudson 2000: 292–315).

What began as a reaction against classical political economy in the 1880s and 1890s became an academic rejection of the labor theory of value and its associated theory of economic rent. Rentier income is now treated as just another profit opportunity to gain from investing tangible or financial capital. Land and monopolistic rent-seeking activities are lumped together as "capital," stripping away the classical distinction between economic rent and normal profit. For the past hundred years, all gains have been portrayed as being earned by providing a service. It was and is blindly assumed that market competition will prevent exploitative economic rents from emerging on more than a temporary basis.

As the 19th century's endorsement of taxing land and its groundrent has dissipated — to say nothing of attempts to nationalize land and key monopolies — the concept of economic rent as unearned income has been dropped from the academic curriculum and public discourse. As Veblen observed, this narrowness appeals to defenders of property precisely because it leaves little room to deal with the landlord's or financier's "unearned increment" that results from rising prices for farmland and urban sites, mineral rights and natural monopolies, or for railroads and trusts that incorporate watered costs into the prices they extort from producers and consumers.

Opponents of distinguishing between earned and unearned income have disparaged progressive reformers and institutionalists as if they had no grounds for a theory. They did indeed have grounds for a theory, but its scope was broader than that of the marginalists, for whom "institutional facts are taken for granted, denied, or explained away." Regarding the financial system, for example, "the effect of credit extension on business traffic is left on one side and there is an explanation of how the borrower and lender co-operate to smooth out their respective income streams of consumable goods or sensations of consumption" (Veblen 1936: 154). The resulting unhistorical and overly abstract views of the marginalists trivialized any analysis of how wealth actually is obtained and what economies are all about.

By being "universal," abstract theory ignores the specific historical modes of wealth accumulation—for instance, what Honoré Balzac expressed when he quipped that behind

every family fortune lies a great, often undiscovered crime. "Market" economics has no room for the discovery of crimes, exploitation, unearned income, economic rent, interest, capital gains, or other asset-price gains, much less a remedy for the imbalances and inequities these phenomena cause. While today's mainstream "free enterprise" economics focuses on the so-called "real" economy, business analysts focus increasingly on developing more rent-seeking activities, whose financing now makes up the majority of bank loans.

The pursuit of wealth is still primarily about rent seeking. This is why the financial approach of Hyman Minsky and his post-Keynesian followers retains the premise that "Institutions must be brought into the analysis at the beginning; useful theory is institution specific" (Papadimitriou and Wray 1998: 201). But instead of viewing this financial rentier overgrowth as stifling the economy, free market doctrine and policy treats it as the essence of today's path to business wealth — in practice, a greed-is-good culture regardless of economy-wide consequences.

To the institutionalists, the purpose of explaining the historical differences among nations was to bring into focus the public policy and financial context that shaped market relations — and by logical extension, on reforms that aimed to regulate, tax, and socialize wealth for the future of the economy. This is anathema to economists who — by definition — deem a "free market" as one steered by financial insiders and other rentiers "free" of public regulation.

Patten thus extended the discussion of economic rent far beyond that of Ricardo. Ricardo dealt with resource rents, not financial rents. The economic problem in Ricardian analysis was landlords seeking protective grain tariffs, but by the late 19th century it was the monopolists and financial trusts that organized and backed them that were the problem. Whereas Ricardo warned that rent-seeking landlords would render Britain a high-cost economy, Patten warned that rent-seeking monopolists and financiers were the major threat to the United States.

Subsequent institutionalists extended the discussion to mining and industrial trusts, the Standard Oil monopoly, and high finance. In their day they were the academic counterparts to investigative journalists in explaining how finance absorbed the insurance and commercial property sectors, fuels, and mining, as well as farming in which financial interests could control the key wholesale marketing, transport, and other choke points.

It may be surprising that the first economics professor at America's first and foremost business school should have been so strong an endorser of public infrastructure. But this is a reminder of how far economic orthodoxy has departed from classical economics and the strategy that

made the U.S. economy the most productive, highest wage, and the most competitive economy in the world.

Catastrophically, what has been lost since Patten's day is an awareness of why public enterprise tends to make economies more competitive than private enterprise. Free market ideology since the 1980s treats privatization as inherently more efficient than public enterprise, even for natural monopolies such as transportation. But private ownership of basic infrastructure — almost always debt leveraged, as is real estate — adds interest and other financial charges, high management fees, stock options, and capital gains to the cost of providing basic services.

It is important to note that public enterprise is free of these charges. Private ownership of natural monopolies creates a vested political interest in deregulation. Owners become rent seeking, charging as high a price as possible over the cost of production. Political lobbying along these lines threatens to turn economies into tollbooth opportunities for price extortion. The end result tends to benefit the financial sector, whose lending turns rent extraction into a flow of interest payments.

Likewise rising valuations on land sites typically are collateralized for increasingly large bank loans. Today, banks rather than the tax collector end up receiving the site rent. This forces governments to tax labor and industry to make up for the loss of the property-tax base, adding to the cost of living and doing business. This is the path along which the United States and other nations are traveling today. It is the opposite from that pursued a century ago during America's rise to economic power, in which Simon Patten and others laid out the logic for keeping rent seeking in check by retaining tollbooth opportunities and economic rent in the public domain. At that time, industrial capital and business found this theory sufficiently reflective of its interests such that Patten's views were taught at the Wharton School as the economic strategy of America's future rise to global dominance. But that is the exact opposite policy from what is being taught and pursued in the United States and throughout most of the world, for the benefit of the few.

Notes

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As Mill put matters in 1848 (Principles of Political Economy, Book V, ch. II §5), rent-yielding properties enabled their holders to demand payment from society "without any exertion or sacrifice on the part of the owners . . . [Landlords] grow richer, as it were in their sleep, without working, risking, or economizing. What claim have they, on the general principle of social justice, to this accession of riches? In what would they have been wronged if society had, from the beginning, reserved the right of taxing the spontaneous increase of rent, to the highest amount required by financial exigencies?"

[2]

Patten (1908b, in 1924: 254) elaborated: "At present there are four classes of property that gain a relatively large share of the benefits of improvements and whose values and costs are most frequently watered. These are the railroads, protected industries, western farms and city lands. A city lot valued at $100,000 or a western farm that sells at $100 an acre represents a higher proportion of watered values than do railroad stocks or the protected trusts." A large proportion of the price of rural and urban real estate consists of the mortgages attached to it, absorbing its rental income in the form of interest charges.

[3]

See Henry (1983: 382): "The year 1890 provides the watershed in the development of Clark's orthodoxy," developing the theory of distribution that became the essence of his 1899 Distribution of Wealth. By contrast, Mason Gaffney (1995) attributes Clark's views and indeed neoclassical economics as a whole to opposition to Henry George's Single Tax program, not to Marx and other socialists. This seems to overlook Clark's writings opposing socialism from 1877 through 1889.

In fact, Gaffney's argument closely follows Patten's 1890 article in the Journal of Ethics, yet makes no reference to its precedence by over a century to the effect that marginal productivity theory treats economic rent as being as fairly earned as all other income—as if rent and interest were payments for landlords, bankers, and financial operators creating a marginal product. More egregiously, Gaffney misses entirely George's failure to apply a rigorous theory of economic rent to non-land rent extraction in the way that Patten did in what best may be characterized as the reformist wing of American industrial capitalism. This neglect does not seem to be innocent. For example, the article by Charles F. Collier (2003) presents a travesty of Patten's thought—censoring his criticism of George and utterly misrepresenting his

view—without citing the discussion of George at all!

[4]

Clark argued along similar lines in his articles on “The Ethics of Land Tenure” (1890a), “The Moral Basis of Property in Land” (1890b), and “Distribution as Determined by a Law of Rent” (1891). Henry (1995) provides a bibliography and analysis of Clark’s development of marginal productivity theory.

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Europe’s aristocratic governments developed their tax policy “at a time when the state was a mere military organization for the defense of society from foreign foes, or to gratify national feelings by aggressive wars.” Such states had a “passive” economic development policy, and their tax philosophy was “based upon moral or political ideals,” not economic efficiency.

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Stated the other way around, transportation facilities would increase outlying land prices along the routes. London’s recent Tube extension along the Jubilee Line, for example, inspired a discussion about whether underground and bus transport can be financed publicly by taxing the higher rental value created for sites along such routes. Paying for capital investment out of such tax levies could provide transportation at subsidized prices, minimizing a major element of the economy’s cost structure.

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