Ground Rent Seeking in U.S. Economic History
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Abstract

The term "rent" originally meant the return on land in classical economics, and later also came to mean economic rent, returns not needed to put factors into production. Much rent seeking has been the transfer of land and land rent via the political process, rents in both senses of the term. This paper argues that rent or transfer seeking is induced by the structure of government, which has remained fundamentally unchanged since the adoption of the U.S. Constitution. Public choice theory indicates that rent seeking would take place during the 19th century, an era often pictured as an era of small government and budgets in balanced or in surplus. Much rent seeking did indeed take place, and the vehicle of transfers in the 1800s was land. With income regarded as an increase of assets, the federal budgets during the 1800s had massive off-budget deficits due to the large amounts of lands transferred, reducing the government's asset endowment. The paper also notes that much of the transfers went to concentrated interests, accompanied by substantial fraud and corruption. The paper concludes with an alternative voting structure that would likely reduce the rent-seeking disease of democracy.

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Rent seeking is a function of government structure. As Charles Rowley (1993, p. 1) puts it, "majoritarian democracy generates a mercantilist economy." A central principle of public-choice theory is that transfer seeking, the "disease of democracy," is a consequence of concentrated benefits and spread-out costs, like an iceberg, in which the benefits above the water are borne by the greater mass beneath the surface. This iceberg effect is caused by the incentives of the political structure, as laid out by Mancur Olson (1971). Olson noted that the incentives change with group size, small groups being less conducive to transfer seeking.1 Rent or transfer seeking is thus an outcome of mass democracy, the existence of large pools of voters electing representatives who depend on expensive media campaigns. The alternative of basing elections on a structure of small groups would induce fewer transfers (Foldvary, 1996), as described in the conclusion.

Although much has changed in American politics since the adoption of the U.S. Constitution, the basic structure of mass democracy has not changed. The main change is the direct election of Senators by the voters in the States rather than by the State legislatures, a change that shifted the recipients of transfers but did not alter the incentives of Senators to engage in the market for legislation. Moreover, as illustrated by the history the political machines of 19th-century American cities, the corruption induced by mass democracy is no recent phenomenon. Henry George, writing in 1871, wrote of "the ease with which a few great rings wrest the whole power of the nation in their aggrandizement" (George, 1871, p. 46).

The inducement to federal rent seeking was present since the adoption of the Constitution. However, the 1800s are regarded as an era of small government, with budgets balanced or in surpluses. "For our first 60 years as a Nation (through 1849), cumulative budget surpluses and deficits yielded a net surplus of $70 million" (Office of Management and Budget, 1997, p. 15). "Prior to the end of the Second World War there was no 'deficit problem'" (Anderson, 1986, p. 9).

Large federal budget deficits are regarded to be a recent phenomenon. Buchanan, Rowley, and Tollison (1986, pp. 4-5) note that there was a "serious breakdown in the post-1960 nexus between constitutional and legislative decision-making. The broad constitutional consensus in favor of prudent household economics crumbles into insignificance when confronted with the pluralistic, interest group dominated political brokering of legislative politics." The growth of the federal government since 1960 and of the federal deficit since 1970 has indeed been congruent with an expansion of transfers.

However, transfers were significant, even massive, in the 19th century as well, but with a different vehicle of transfer than in the 20th century. The vehicle of the 1800s was not funds obtained by taxation, but an endowment held by the government: land. The land, including natural resources, constituted an enormous stock of assets available for transfer to those with sufficient clout to obtain them. At first, land was sold and generated revenue, but soon, as explained by Anderson and Martin (1987), the land policy became an immense rent-seeking transfer program. Throughout the 19th-century, the federal government gave out land rents as political favors, a practice which continues to the present day. This has been rent-seeking with a double meaning, the political rents being constituted as ground rents. The proposition that the practice is endemic in the structure of government is consistent also with policy going back to ancient times. As noted by Henry George (1871, p. 47), the Senate of ancient Rome had "granted away the public domain in large tracts, just as our Senate is doing now."

These land transfers were not a historical accident, but played a key role in the founding of the government of the United States. Charles Beard (1913) identified three key interest groups that supported the Constitutional Convention: money lenders, protection-seeking manufacturers, and land speculators. A key advantage of the Constitution to the land seekers was that it would empower the central government to take the Indian lands with its national army (Friedenberg, 1992, p. 325). Land located where the Indians were a threat appreciated in value with the prospect of protection by the new government (McDonald, 1958, p. 395). In several Southern states, the western land issue was the key factor in ratifying the Constitution, as the tariff was to northern states. (Ironically, western expansion would later be a cause for secession.) Friedenberg (1992, p. 327) concludes that "without the support of key political figures deeply involved in land speculation, the Constitution would not have been adopted."

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Western interests opposed using the land sales for revenue, preferring to keep land cheap. President Andrew Jackson in 1832 favored disposing of the lands at a low price to speed up settlement. Since the national debt was almost paid off, he advocated that the land transfers "shall cease as soon as practicable to be a source of revenue" (Wellington, 1914, p. 42).

As Peter Barnes (1971, part 1) put it, "the typical speculator's gambit was to form a "company" which would bid for massive grants from Congress or the state legislatures, generally on the pretext of promoting colonization. Once a grant was obtained - and it never hurt to be generous with bribes - the land would be divided and resold to settlers, or, more likely, to other speculators. The enormous Yazoo land frauds-in which 30 million acres, consisting of nearly the entirety of the present states of Alabama and Mississippi, were sold by the Georgia legislature for less than two cents an acre, and then resold in the form of scrip to thousands of gullible investors - was perhaps the most famous of these profit-making schemes. Huge fortunes were made in such swindles, often by some of the most respected names in government."

The land transfers to speculators for resale did not merely enrich a few at the expense of many, but affected the subsequent settlement of the country. The speculative demand increased land prices and thus hindered settlement by those who lacked the means to purchase land. As noted by Hibbard (1924, p. 219), speculative purchases "held land out of the market for at least a time and so compelled settlement to pass around or across it." Agriculture was often held back, since speculation was regarded as more profitable until the bulk of the land was claimed. Government policy facilitated it because many officials were involved. "It was an open secret that many members of Congress were deeply involved in land speculation" (Hibbard, 1924, p. 219).

Many of the grants and purchases were not subdivided, and thus led to a pattern of concentrated land holding which has, if anything, intensified. The Gini coefficient among farms has risen from .57 in 1910 to .76 in 1987, and the measure is .92 if one adjusts for the loss of farms (Gaffney, 1993, p. 120).

In 1835, with the national debt paid off, the federal government began generating a surplus based on land sales tied to expanding bank credits protected by securities provided by land speculators in return for bank paper which was used to buy ever more public land at $1.25 per acre. The government surplus was thus a paper surplus (Wellington, 1914, p. 49), the land sales now tied to the issue of excessive bank credit.

Much of the land speculation in the U.S. has been related to government public works projects, which greatly increase the value of the land serviced. In the 1830s, the stimulus was canal building. The success of the Erie Canal in New York State and the rapid rise of land values along its route led to the extension of the same speculative calculations to Chicago when a canal linking Lake Michigan (and New York via the Erie Canal) to the Mississippi River was proposed. In 1833, the federal government appropriated $25,000 to dredge the harbor. The local Black Hawk Indians were subdued by federal and local troops in 1832, sparking a rush of settlers to Chicago (Hoyt, 1933, p. 19).

The speculative mania was fed by a "superabundance of paper money issued under diverse state laws" (Hoyt, 1933, p. 28). Government lands could be purchased with irredeemable "rag money" created by the state-controlled "wildcat" banks (Sakolski, 1932, p. 234). The newly chartered State Bank of Illinois was empowered to loan funds for real estate. A branch of the bank was established in Chicago in December 1835. "One of the most potent devices for raising land values, liberal credit to land buyers, was thereby created" (Hoyt, 1933, p. 27). Various government interventions were thus tied to the land-rent seeking: transfers of land, public works, and state control of the banking system.

Jackson issued the specie circular of July 11, 1836, requiring payment for land in gold and silver (Wellington, 1914, p. 51). Speculation ceased, but the damage had been done. Land prices had nowhere to go but down. In May 1837, the banks of New York suspended specie payments and there was a tightening of the money market. On May 29, 1837, the Illinois banks suspended specie payments, backed by a special act of the legislature. It became impossible to borrow money on real estate or to renew existing loans. The panic of 1837 became a national holdings far in excess of 160 acres, and the Land Office lacked either the will or the ability to stop them" (Barnes, 1971, part 5).

Homesteaders as actual settlers were supposed to have priority before public sales of land, but in practice, there were public sales before lands were settled. Speculators were thus able to obtain choice lands at low prices, often circumventing the law. "By means of cabins built on wheels or at the intersection of quarter section lines, and false affidavits, a good deal of land grabbing has also been done under the pre-emption and homestead laws" (George, 1871, p. 5).

After the Civil War, "Chicago shared the zeal for public improvements with many American cities". These included sewers, street paving, lamp posts, and bridges. "Lavish expenditures for improvements, and some political corruption, were blended in the land boom that culminated in 1873" (Hoyt, 1933, p. 88). Post Civil-War land values gained impetus near parks and boulevards. One contemporary writer noted that "the city acceded to the demand of every real estate speculator who asked for improvements" (p. 117). The value of real estate was often raised on the strength of projected improvements. By 1873, business profits were receding. Wages declined. Land values halted their advance. The stock market crashed, and commercial failures brought on the Panic of 1873.

As Wellington (1914, p. 115) concludes with respect to the land policy, a "really scientific law could not have been enacted, for it would have been opposed by those sections which regarded it as harmful to their interests."

Recipients of Land Grants

Most grants of land by the federal government to individuals went to war veterans, amounting to 78 million acres. Land payments to veterans began with the Revolutionary War, with soldiers paid in script for claims on western land. The land debt in turn created pressure to kill and remove the Indians, which required a strong national government (Friedenberg, 1992, p. 356). The plantation and patroon lords used State-backed paper money to buy up the confiscated Loyalist lands (p. 357).

Congress rewarded veterans of the War of 1812 and the Mexican War with land in Ohio, Michigan, Illinois, Maryland, and Arkansas (Gates, 1984, p. 38). These grants could be considered as part of the payments for military services rendered, hence not rent transfers. However, the transfers were in the form of warrants for land, almost all of which were sold to land speculators rather than exercised for land. The yield to the warrant sellers has been estimated at 25 cents per acre. The opportunity cost of these land grants was the funds that could have been raised by sales, amounting to $91 million at $1.25 per acre, while even at 50c per acre the soldiers obtained only a total of $36 million. Settlers paid about $2 per acre to the speculators who bought the warrants (George, 1871, p. 6). Thus, even payments in kind for military services led to a substantial transfer of unearned rents compared to the maximum the government could have obtained for the lands.

The federal government also transferred large amounts of lands to the States for public works, government buildings, schools and colleges, and reclamation. Though the explicit recipients were the State governments, this rent seeking originated with the manufacturing interests of the North Atlantic States. Homesteading would induce emigration to the west, raising obtaining the grants. Secondly, investments made because of a subsidy draw funds from other investments which could have been made, which customers at the time are willing to pay for. The opportunity costs were recognized by Henry George (1871, p. 11), long before the concept became familiar to economists: "for the investment in capital in one enterprise prevents its investment in another."

Land transfers in California

Land transfers in California followed a pattern similar to that of the United States: massive transfers to concentrated recipients. Even with a population of only some 600,000 in 1870, the same voting structure, mass democracy, induced the same type of land rent seeking, indicating that just having a smaller scale (lower population) does not reduce the extent of rent seeking.

A lasting effect of the 19th-century land transfers is the continuing high concentration of landownership in California. A 1970 study by the University of California Agricultural Extension Service found that 3.7 million acres of California farmland are owned by 45 corporate farms. This constitutes nearly half of the agricultural land in the state and about three-quarters of the prime irrigated land (Barnes, 1971, part 3).

California's land transfers had a special feature, the Mexican land grants (which existed also in other Mexican territories such as New Mexico), in turn inherited from Spanish grants. By the terms of the cession of California to the United States, these land rights were retained. Some of the original Spanish grants have been retained as giant holdings today, including the Irvine Ranch (88,000 acres in Orange County), the Tejon Ranch (268,000 acres in the hills and valleys northeast of Los Angeles, 40 percent owned by the Chandler family (which publishes the Los Angeles Times), Rancho California (97,000 acres to the northeast of San Diego, jointly owned by Kaiser and Aetna Life), and the Newhall Ranch (43,000 acres north of Los Angeles) (Barnes, 1971, part 3).

The borders of these grants were often not well determined, and this left many titles uncertain and unsettled, hence subject to litigation. Being unfamiliar with American law, native Mexican grant holders were taken advantage of by land speculators and their lawyers. Most of the grants passed on to other owners (George, 1871, p. 14). This constituted a subtle form of land takings, the law permitted or did not prevent a massive transfer of titles by means of fraud, such as with forged title papers. According to George (p. 15), "there are pieces of land in California for which four or five different titles have been purchased."

Besides the fraudulent land transfers based on historic grants, there were bogus grants, sometimes bearing the signatures of former Mexican officiatarchasings tod 1 480.22 474.55 Tm[(-)21.872(mes b

Henry Miller's acquisitions illustrate the methods used. The Swamp Lands Act provided lands to individuals free of charge if they would agree to drain them. "The law provided that the land had to be underwater and traversable only by boat. Miller loaded a rowboat onto the back end of a wagon and had a team of horses pull him and his dinghy across his desired grassland. Eventually the government received a map of the territory from Miller, together with a sworn statement that he had crossed in a boat. Thousands of acres thus became his" (Barnes, 1971, part 3).

In 1877 under the impetus of California's Senator Sargent, who acted on behalf of Haggin and Tevis, San Francisco tycoons, Congress approved the Desert Land Act, the bill signed by President Grant in the last days of his administration. The law removed several hundred thousand acres from settlement under the Homestead Act. These lands, alleged to be worthless desert, were to be sold in 640-acre sections to any individual who promised to provide irrigation. The price was 25 cents per acre down, with an additional $1 per acre to be paid after reclamation.

"The chunk of it eyed by Haggin and Tevis was located close to the Kern River, and was partially settled. A San Francisco Chronicle story of 1877 describes what happened next: The President's signature was not dry on the cunningly devised enactment before Boss Carr [Haggin and Tevis' agent in the valley] and his confederates were advised from Washington that the breach was open. It was Saturday, the 31st of March. The applications were in readiness, sworn and subscribed by proxies... All that Saturday night and the following... Alen3(c)-5(a)4(ti)-3(ons we)5(r)-6(o unb were below the market value of the timber. Also, under the "Timber Cutting Act vast areas of the forest regions were stripped of valuable timber without any returns whatever" (p. 457).

The electro-magnetic spectrum

The Radio Act of 1927 established the Federal Radio Commission, followed by the Communications Act of 1934 and the establishment of the Federal Communications Commission (FCC) ("The FCC," 1997), which regulates the non-federal electro-magnetic spectrum. In 1996, sections of the spectrum were sold by the FCC at auction. Previously, however, some $100 billion of spectrum was given to American broadcast companies (Karrigan, 1995). The government doubled the amount of spectrum each broadcaster controlled. Originally intended for High Definition Television, the space is now available for other uses such as paging and cellular telephones. Thus, land-rent seeking and taking continues in new forms.

Rent Seeking via Capitalization

Adam Smith (1976 [1776], Book I, p. 275) noted that "Every improvement in the circumstances of society tends either directly or indirectly to raise the real rent of land, to increase the wealth of the landlord." The rental value of land is increased by externalities that add to the demand to be located at some site. As noted by Jasinowski (1973, p. 10), when subsidies are tied to territory, the price of land rises by the present value of the future stream of benefits that come with the ownership of land. Once granted, capitalized expectations become a powerful political force in resisting any reduction in the subsidy, since that decreases the value of the land.

An example, Boxley and Anderson (1973, pp. 88-9) report on research findings that farms sold with tobacco allotments were enhanced by $300-600 per acre in 1945 and $1673-2500 in 1957. Comparable values have been found for peanuts (p. 90). The subsidy to sugar production, which is protected from competition by quotas and a tariff, has also been found to become capitalized in higher land values, has raised the value of sugar-beet farms (Ballinger, 1973). That landowners rather than farm workers have benefited from the subsidies is shown by the increase of the labor-price of a farm from 6 years' wages to 17 years' wages from 1954 to 1987 (Gaffney, 1993, p. 120).

The capitalization of urban government services has been tested by several studies. Among them, Oates (1969) concluded that services and property taxes were indeed capitalized. Sonstelie and Portney (1980), using gross rentals and amount of tax rather than tax rates, found empirical evidence for the capitalization of community services, including public safety, fire protection, streets, reduction of pollution, and education. Stern and Ayres (1973, p. 131) conclude that transportation outlays are typically "more than fully reflected in increased rents and land values."

The provision of such services and subsidies from taxes on wage income and capital returns are thus a transfer of wealth to the owners of the real estate whose value is capitalized.

The problem in land transfers

Transfer seeking is deplored both because it forcibly reallocates resources, because of the social waste or loss of resources, and because of the inequality of granting privileges to concentrated special interests. In the case of the historic land transfers, resources were not extracted from producers, but taken from the natural endowment. Hence, while one could deplore the corruption and unequal allocation, some might argue that there was no damage to future generations, there was no excess burden in simply allocating land, and it does not matter from a social viewpoint who now has title to the land.

However, the massive land-rent seeking has had lasting negative effects. First, there was the opportunity cost of the transfers. If a country has some collective endowment of wealth, then this provides an opportunity for perpetual income that can substitute for taxation that imposes an excess burden. Secondly, the allocation of land to a privileged few denied the population of the United States an equal opportunity to use its natural resources and created lasting inequalities in wealth. In agriculture, for example, the four percent of the private landowners with the largest holdings own 47 percent of the land (Wunderlich, 1993, p. 5). As noted by Paul Gates (1924, p. xii), "Within a generation or two, forces governing prices sent land values to hundreds of dollars per acre and produced the rapid emergence of tenancy. Giving land away did not assure permanent family farm ownership."

The land policy of the U.S. government has also had the effect of burdening workers with high taxes on their wages and on their financial investments, and hampering the growth of wealth and industry, having foregone the opportunity to fund the government instead from the rent that would have been generated from the lands that were given away.

The effects of land-rent seeking in the U.S. even extend to economic science, as the authorities governing universities funded by gains from rent seeking might select compatible faculty and thus viewpoints. Neoclassical economics may have thus been influenced by land-rent seeking. A key institution was Cornell University, named for Ezra Cornell, founder of Western Union. Both Ezra Cornell and the Cornell University held massive amounts of western land. The Morrill (Agricultural) Act of 1862 had given land script to the states in proportion to their populations, giving New York a large share. Ezra Cornell obtained over a half million acres of position as absentee land speculators." Besides shifting the very meaning of rent, Johnson explicitly rejected the case for obtaining public revenue from land rent in his 1914 article in the Atlantic Monthly, "The Case against the Single Tax." Johnson was a mentor of Frank Knight at civic services would also have preserved decentralization and facilitated the privatization of community services, the rent paid to private developers and civic associations (Foldvary, 1994), since rent is more feasibly collected locally than are taxes on productive processes.

Secondly, the prevention of transfer seeking and its associated corruption requires fundamental reforms in the voting process. Constitutional restraints on policy and the funding of candidates are insufficient. Large-group democracy creates a structure with incentives for transfer seeking that are too strong to contain by limits on funding and activities. The public cannot and will not act to monitor and prevent the transfers, as shown by the history of the U.S. since its founding.

The fundamental governance reform that would prevent such rent seeking is a restructuring of voting to small-group democracy, with all voting taking place only in small groups or communities (Foldvary, 1996). Such a communitarian democracy would be based on the local neighborhood with a size small enough so that 1) the candidates would be personally known by the voters, 2) there would be little cost or effort for a person to become a representative, and 3) media campaigns would be redundant, hence funding superfluous.

Local neighborhoods of some 500 persons (150 voters) would elect councils, the members recallable at any time. These councils in turn elect higher-level councils representing blocks of 12-20 neighborhood councils. The process would continue to ever higher level councils up to the city, State, and federal governments. At each level, representatives would be drawn from the lower-level councils and would be recallable at any time.

This would leave powerful interests with little leverage in obtaining transfers and privileges. The demand for funds for media campaigns would be much reduced, if not eliminated. This bottom-up multi-level structure would provide incentives for both voting and monitoring, since for each level a small group elects its representatives and can recall them when dissatisfied. If corruption took place at the top, the level below could quickly change the policy or recall the officials; if not, then the next lower levels would be able to recall those representatives, and so on down to voters at the bottom.

We have seen the same type of massive privatization transfers to the politically powerful interests in the de-socialized newly democratic countries of Eastern Europe as took place in the United States with the land. Similar political structure induce similar outcomes. This paper has shown that the transfer process in the U.S. was massive, corrupt, and fraudulent in the 19th century, the vehicle then being land rather than tax funds. The analysis here has argued that these transfers resulted from two Constitutional failures: the failure to articulate a market-based land policy, and the failure to structure democracy so as to avoid the dysfunctional impotence and rational ignorance of the public.

Note

1. I concur with Leland Yeager's (1995, p. 386) suggestion that "rent seeking" has been "a misleading term from the start" and that "we would do well to ... speak of efforts to enlist government for one's own special purposes as transfer-seeking."

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