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Henry George School of Social Science
50 East 69th Street, New York, N.Y. 10021

Equity of Heavier Reliance on Land Taxation (Location Value) and Less on Improvements[1]

C. Lowell Harriss
Professor of Economics, Columbia University;
Economic Consultant, Tax Foundation, Inc.[2]

Greater fairness in sharing the costs of local government constitutes a prime —*but not the only*—reason for shifting much of the tax from improvements to land. This country will be around for a long time. So also, I hope, will meaningful local government. Effective freedom requires financial independence, including ability and responsibility for raising revenue.

One of the biggest legacies we leave our children will be the tax system. We want to make it as good as possible. *Equity* is one (again, not the only) element of "goodness" of a tax system.

Equity: A Complex Concept

The concepts of "equity," "justice," and "fairness" as applied to sharing the cost of local government must present endless challenges of definition. Matters of the meanings of these concepts are by no means so clear as to give us reliable guides for settling the complex questions at issue here. Even for taxes which apply nation-wide, *equity* issues are maddeningly complex. For example, who would not agree with the statement: "The federal personal income tax is grossly inequitable in some respects; highly inequitable in others; in some cases, however, it is generally about as good on equity grounds as anything in an imperfect world, and in some ways it rates 'excellent,'"? Yet we would differ sharply in selecting the specific income tax features which fall at the various points on a scale from horribly inequitable to about the best possible.

For financing *local* government, the concept of fairness, of equity, must reflect other considerations, not least being the features of local spending. For example, if taxpayers generally finance community improvements which enhance the worth of some parcels of land, then an argument, which seems overpowering on equity grounds, arises for taxing the values so created. Some

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[1] See C. Lowell Harriss, "Land Value Taxation: Pro," *International Property Assessment Administration, Volume 2,* Chicago: International Association of Assessing Officers, 1970, pp. 59-75. The present paper includes material which follows closely from my Morrison Lecture at DePauw University, *Property Tax Reform: More Progress, Less Poverty,* Greencastle: DePauw University, 1970, 26 p. Assistance from the John C. Lincoln Institute, University of Hartford, is gratefully recognized.

[2] Views expressed are my own and not necessarily those of any organization with which I am associated.

of my other views about the meaning of the "equity" for present purposes will be implicit in the comments below.

"The" property tax—economically two quite different levies (one on land or location value and one on improvements)—is not, and should not be judged as, a tax on income or a tax on net worth (net wealth or capital). "Ability to pay" is at best a highly ambiguous term. As it is popularly used it has limited applicability in judging property taxation in the "mushy" vagueness of common usage, and even less usefulness for purposes of distinguishing the fairness of taxing land as compared with improvements.

What Is Proposed

Substantial reduction in the tax rates on improvements—*including capital investments by the owner in land*—would be financed by sharply increased reliance on land *(location)* values. Definition of "land" for the purposes of the proposal presents real problems, but they are not beyond man's capacity to solve. Admittedly the concept of land—land value, site value—requires refinement, especially when a high tax rate is involved. Here lies one of the many problems of transition.[3] The term "location value" may well be more appropriate, and I shall use it frequently. It conveys, I trust, a distinction between (a) the results of the use of capital and labor by present and past owners to make a part of the earth's surface more valuable and (b) the results of community action (governmental spending and rising demand for space) affecting the amount people will pay for the use of one as against other locations.

The shift would be made in stages within a period of perhaps five years. My proposal would *not* in itself produce a change in total revenue.

Some communities might move at once. Others, even within the same state, might delay. Those communities acting soonest to cut tax on improvements would benefit from attracting more of the flow of the economy's new capital. Our first equity issue: Would this advantage as compared with the effects on other localities be inequitable? Only a straining of terms, it seems to me, would so indicate.

The "goal" might be a rate of tax on location (land) value of three or four times that on improvements.[4] Increasingly, the tax on buildings might become

[3] See my article, "Transition to Land Value Taxation: Some Major Problems," in *The Assessment of Land Value,* Daniel M. Holland, Editor, published in 1970 by the University of Wisconsin Press for the Committee on Taxation, Resources, and Economic Development.

[4] The reasons for keeping some tax on improvements require more explanation than is possible here; some are admittedly debatable. They go beyond the equity focus of this paper. In general, if consumption is to be taxed as heavily as seems to be necessary to finance our desired levels of governmental expenditures, the consumption involved in the use of structures may well have proper place. Moreover, the difficulties of separating the pure land from the improvements elements add a reason for not seeking full exemption of structures.

a levy associated with factors other than value. Such things as size and use, for example, seem to me more logically related to the costs of local government service than does value. This range of matters presents considerations calling for further analysis. Land (location value) might also be taxed to some extent on bases other than value, especially according to area and distance (from a population center) as related to the cost of some local government services. The proposal would *not,* as a rule, raise issues of *shifting more tax to farmers as a group* if the total of local government spending does not change. There would be differences among farms according to the amount of capital which has been invested by past and present owners to enhance the worth of what God provided. Separating out past inputs of capital and labor would be less than ideally precise, but for the future the record-keeping would be no more than required for income tax purposes.[5]

Transition Distinguished From Eventual Condition: Equity Aspects

Two markedly different sets of equity issues command attention. The one of dominant concern ought to be the situation in which we (and our children) would carry on our affairs *after generally full adjustment* as contrasted with conditions then if present practices were to continue. The *long run* in which "we" are *not* all dead! The other concern involves the *transition.* The shift itself would produce results distinguishable from those to prevail after the economy had settled down to the new system.

When it is government rather than the free market that originates the changes, questions of public policy arise. Some people will be hurt and others benefited without any close relation to their own actions and choices. The Tax Reform Act of 1969 was a source of such changes. Many others come about, e.g., zoning, one sort or another of regulations, monetary policy. The discriminatory results lose much of their apparent social significance with the passing of time. Meanwhile, there build up gradually various new conditions—a new *economic framework.* People carry on their affairs in a different environment. Will the resulting differences involve more or less equity in sharing the costs of local government? Will payment for the benefits of community spending that affect the values of different locations be shared more equitably?

[5] An alternative for the first two or three years, as an aid to transition, might be to confine all increases in property tax burdens to land values; a potential drawback would be the invitation to use the reform as a vehicle for making tax burdens higher than otherwise and then not to proceed with relief to buildings. Moreover, no progress toward the goal would result where tax rates are stable or declining, as one should expect in many localities if assessments are improved. Another transition possibility would be to exempt (largely if not entirely) new buildings and other inputs of capital for, perhaps, three to five years by which time all structures would be subject to a much reduced rate. This proposal would tend to stimulate investment and raise the demand for land; some owners of older buildings, thus forced to compete with new ones, would have a legitimate complaint of unfair treatment.

Transition

The vast majority of property owners and users would not have their existing taxes changed "much."[6] For most homeowners the total difference in tax would probably not be down or up more than $1 or $2 a month in any one year. This guess, and I admit that it is just that, assumes that in any community a large fraction of residential properties are close to the average in the relation of land to building value. Recall, no change in total tax is envisaged! The change would not seem to me to be enough to justify appreciable controversy on grounds of equity—but this value judgment is personal.

The Fine Building

One equity issue of the transition would be the reduction of tax on fine structures—new, modern, highly valued buildings (especially if the land is in other ownership).[7] Where improvements are large relative to land, there will be tax relief. Perhaps a few cases of large amount would seem clearly undeserving. The owners of such buildings would benefit, but not much individually where corporations with many shareholders are the owners. The relief in most cases would not seem to me to be great enough to justify much controversy on grounds of equity; but this personal judgment can obviously be questioned. Magnitudes would, of course, depend upon local conditions. Two groups might be distinguishable—the "worthy" who would be relieved of formerly excessive burdens and the undeserving who would now pay less for no new contribution on their part. But you and I might assign rather different groupings. If there is net inequity, some would certainly be a price worth paying for a reform which over the longer run would have many advantages on grounds of equity and other benefits as well.

To the extent that the structures getting much relief will have been built or purchased *since* imposition of the "present" tax rates (those rates being reduced), there will be a positive windfall. There will be properties in the typical city where the property tax rate has gone up from year to year, and where many of the best of buildings in place are not new. In such cases the

[6] Professor Schaaf criticizes site value taxation on the grounds of probable burden on low-income groups. But he is quite clear that the conclusion rests on an assumption that in the *short run* an increase in land taxes can be shifted to tenants. This wide departure from standard economic analysis, as he recognizes, depends upon assumptions applicable to the *short run*. Some may well be valid, in some cases for limited periods. But market forces operate, not perfectly but overwhelmingly, to put an increase in land tax on the owner of land. (Long-term leases and escalator clauses must be taken into account.) The encouragement of new building would enlarge the housing stock and speed up the improvement of living conditions for all. The "filtering upward" process works better, the larger the number of alternatives.

[7] Public utilities would present problems calling for special consideration not covered here. Often subject to high ad valorem taxes now, their ownership of land is frequently low relative to their total assets. Businesses with large amounts of taxed inventories would also be relieved of tax.

amount of "excess" tax relief, over and above the increase in land tax, may seem unreasonable and unmerited. However, the original capital investment may have been receiving an unduly low net return; but facts will vary widely. The amounts will differ from one city to another and one property to another.

The number of cases of "large" tax relief could not be great—especially if the transition is phased in over five years or so. The flows of new capital and the negotiations of new rental agreements would have opportunity to work many offsets during such a period.

The Extreme Case Not a Good Basis for General Public Policy

A basic proposition warrants statement. It applies to both ends of a spectrum, in this case large unmerited gains and losses. A *few* cases of large benefits—and some of large losses—may seem inevitable, but they ought not to be allowed to determine the issue for the entire public.[8] If one thing is clear, it is that *wise policy for society as a whole cannot result from focusing on a few extremes.* These do deserve consideration in making policy. But vastly greater weight ought to be given to the *majority* of cases, first during the transition and then over the long run.

Underutilized Land

Where land is vacant and idle or much underutilized, as with deteriorated slum structures, the tax would rise—and by quite a bit. Whether himself the user (for residential or business purposes, including farming on the urban fringe) or leasing to another, the owner would face new, unwelcome conditions. The contrast with the owner of the fine building does warrant concern. And my sampling of views suggests that the "typical" American has quite an identification with the land "speculator"! I would not suggest an atavistic feeling for land ownership, a sympathy for land speculation which has an old (and honored?) tradition in this country, or a powerful sense of conviction that holding land deserves special consideration. Yet my sampling does suggest more than a random—or rational—bias favoring the owner of land, even (or especially?) underutilized land.

The case of underutilized land whose value declines more than moderately as a result of the tax increase does require attention. The person who has bought recently at a price which reflected the capitalization of then existing property tax burdens would properly complain, "Unfair."[9]

The fruits of community spending on public facilities and the benefits of rising demand due to social forces will have been capitalized by earlier own-

[8] Federal and state income tax obligations would absorb some of the special transition gains and losses, but such cushioning effects are incomplete and partial.

[9] Let us assume adequate assessment, not the relative underassessment sometimes found for vacant and underutilized land. In fact, underassessment may have given an unfair advantage for years.

ers of location. Bygones are bygones. Old inequities can be ignored—*except* as they point out lessons for the future.

Much would depend upon the quality of assessments. The sense of unfairness that worries some critics of my proposal stems to large extent, really, from an unrecognized (but not unimportant) fear that assessments would not reflect changing conditions with reasonable accuracy. Yet this danger, being recognized in advance, can, hopefully, be forestalled by upgrading the assessment process. Here lies one of the big challenges of government quite independent of a shift to greater reliance upon location values for financing local government.

For owners of land having little in the way of improvements (little in value though perhaps quite a bit of space in an obsolete building), tax changes as capitalized, even though the transition is gradual, would sometimes be more than nominal. But actual magnitudes are easily exaggerated.

Some owners of vacant land, for example, might come off surprisingly well; they would be in a position to take quick advantage of the new conditions, the enlarged flow of new capital to build new and better (tall) structures to make fuller use of the potentials of location. The enlarged supply of new structures would enhance the opportunities of occupants of all types. The filtering process would work with greater scope. This favorable dimension of equity might positively affect more people than the other results from the change.

Transition Relief?

Where losses do result, the justice, or injustice, of such change ought to be faced frankly. Can it not be argued—argued with solid basis in equity—that society owes rather little to the owner who has kept land in a use much below its potential?[10]

Withholding of a resource scarcely seems to justify compensation in the form of social commitment to avoid action which will make such withholding more costly!

The fact that an owner has been content to accept a return below what the market would have paid does not vest in him a claim on society of a right to continue on such terms. Or do we unconsciously identify with "speculation" in land?

Still, equity does require that changing the "rules of the game" must not be done without regard for implied as well as explicit commitments. For the transition, even with a five-year spread, I would, "in principle," welcome some adjustment to ease the more extreme cases. Individuals as owners, whether singly or in groups, likely to incur "large" capital losses might well deserve

[10] The waiting for land to "ripen" can provide an exception. Such cases will exist. Whether they are one-tenth or one-fifth or one-twentieth of speculative underutilization, I would not pretend to know.

consideration. If real losers could be compensated, the price would be modest in relation to the long-run benefits to the community.[11]

The practical difficulties of any such compensation plans are formidable. (The mere existence of the possibility would add to the "need" because sharp owners of vacant land would tend to buy and sell to take account of the prospective remedy.) Frankly, I am not hopeful about this potential transition device. Nor does the need seem likely to be great.

The amount of transition effect would depend upon the extent of preparation in advance. Surprises are hardly conceivable. The inevitable discussion would extend over years. The approaching possibility would tend to get into the prices of land and buildings. The incorporation into prices attached to location (land) values of *prospective* tax changes would decline as the possibility of cutting taxes on buildings and raising them on land became more probable. Purchasers in, say, 1975 would not be much surprised. The change in land prices in the first year of transition would not be felt as if a big shift suddenly became effective on one single day. Meanwhile, many other forces would be influencing property values. Therefore, determining within any high degree of precision the actual effect of the tax change would be impossible. If two, three, or more years had preceded action, the problem of significant amounts of gain and loss would be only a small fraction of the fears which opponents can be expected to marshal and exploit.

The flow of capital into new building would also begin to respond to prospects. The nearer the approach of relief for buildings, the larger the chance that construction will rise to anticipate, and thus to spread, the benefits.

Longer-Run Equity

Community Use of Values Created by Social Development and Local Government Spending

Over the longer run, landowners would get less of the increment in the values of location. The general public would get more in the form of a larger flow of the rising yields of the worth of location (land) to finance local services. On this score, the equity results commend themselves very strongly indeed. *Socially created values would go for governmental, rather than for private, uses*—and *locally*. The absorption of the increments for local, rather than for state or national, governmental use would channel these funds on a benefit basis geographically.[12]

[11] The appropriate type of compensation would not be a capital payment by the community except in the few cases of direct acquisition. And it ought not to be anything which would relax pressure on the landowner to put land to "higher and better use." In "theory" one might argue for a sort of windfall tax on owners of the finest improvements to subsidize the owners of vacant land—or is such a suggestion out of the question in principle as well as in practice?

[12] Suggestions that the federal income tax on capital gains will capture some of the increment do not provide for the revenues to flow to the particular local government

The localities doing most to make themselves attractive would have most of this revenue source. In major cities $10,000 to $15,000 (now often considerably more) of *governmental* outlay is frequently needed for each new dwelling unit—schools, streets, fire and police, sanitation and health, park and prison, facilities. Under present arrangements much benefit from such outlays in developing areas accrues to the owner of locations being "ripened" for more lucrative use; his payment in taxes (and special assessments) toward the cost will generally be only a modest portion of the total.[13]

Lower Tax on Improvements

What would be the equity of lower taxes on buildings? The answer depends upon shifting (in the longer run) of the tax on improvements. The debate among economists would hinge upon the extent to which the tax falls on returns to capital compared with the portion falling on consumers. My answer has been that the tax on improvements is generally a consumption tax. If so, the great bulk of the bill is shared more or less in proportion to income because in the vast middle-income range consumption is roughly proportional to income. However, regressive elements exist at both extremes of the income scale. In relation to income, the relief would tend to favor lower income groups. To the extent that the tax falls on suppliers of capital, analysis becomes more complex; but for present purposes the amounts of differences would not be large enough to justify much concern.

Most of the relief would be spread more or less gradually over the years, generally in proportion to income.

"Burdensomeless" Tax

As for the future, the tax on values of location above their present levels would be almost burdensomeless, except as owners of land and their heirs get less of the "unearned increment" of rising values over the decades. Much of the element of *true economic surplus* would be used for public purposes. For those parcels of land whose values drop, the annual tax would also decline. Then, because tax rates on land would be higher than today, local government would share more fully in the loss of worth. For landowners the proposal would not be a one-way affair which assumes that land always rises in price.

No other revenue source seems to me to compare so favorably on this score

where the land is located. Where national government funds are spent in ways enhancing local land values, a practice which seems to me suspect, the merits of the federal capital gains tax will have more appeal. Location values are not the only ones affected by social forces more or less beyond individual control. The fact that not all are reached does not indicate that taxing some will be inequitable. The supply conditions of land *do* differ from those of other types of property.

13 Where the developer incurs part of the expense and charges the buyer, that portion of the payment for land is a capital improvement not appropriately a part of the land value which ought to be subject to the higher of the two tax rates (one on location value, one on improvements).

of fairness.[14] Future users of land would be no worse off for the much heavier tax they would pay on the value of location. The purchase price of land would be correspondingly less. Of the total flow of yield of location value, interest (explicit or implicit) would be smaller, taxes higher. Who would be less well off? The landowners and their heirs who would have gotten the (unearned) increments![15]

More of the rise in land value which results from (1) governmental investment in community facilities and (2) the general rise in demand due to the growth of population and income would go to pay for the costs of local government. Such a tax on a pure economic surplus seems to me about as fair as any imaginable source of funds for financing community services. The National (Douglas) Commission on Urban Problems estimated that in the 10 years to 1966, and despite rising interest and tax rates, land prices rose by over $5,000 per American family—$250,000 million.[16] Even a modest fraction of this amount if used for local government would have permitted quite a *reduction of burden on buildings*. The estimated rise in land prices was over four times the total growth of state-local debt and was greater than *all* of the property tax paid in the 10-year period.

Finally among the points bearing upon fairness, I quote from Mason Gaffney:

> . . . unearned enrichment discredits wealth and property. Instead of being a mark of distinction, a symbol of productivity and service, such unearned wealth symbolizes predation, dependency, and corruption. Unearned wealth makes hypocrisy and a mockery of efforts to legitimize property and rationalize capitalism. Parasitic wealth stigmatizes all wealth. The latent sense of civic community and polity, now so frustrated in American cities, is lost between the avarice of some and the disgust of others. Not to tax rent, therefore, is to alienate those outside a small circle, and lose a valuable resource of community spirit.[17]

14 The amounts of which owners in the future would be deprived have no systematic relation to wealth, income, or consumption. The concept of equity as related to such factors lies in a different plane of analysis or consideration—valid and important but a goal reachable in other ways only.

15 Even this latter sort of burden, a disappointment, can be largely eliminated. How? By building a society in which such expectations get no support. Land prices now include some element of expectation of future increases in the value of location. The proposal, by destroying such hopes, no matter how small, would impose some "unearned decrement" on the present owner. How large? I have no way of knowing, but with the gradualness of a five-year transition and discount rates now 8 per cent or more, the losses could hardly be large as a percentage of value. No complete ending of private title to increases in land values would be consistent with economic efficiency in land use. No such goal could be achieved without destroying the potential benefits from owner search for the best use of land. Going too far would work damage for which no remedy would be available, no remedy which would operate more or less automatically, within the general framework proposed.

16 Professor Gottlieb questions the accuracy of the estimate. Even if his doubts are justified, there can be no question that in the last 15 or 20 years land prices have gone up—and by far more than the owners invested in making land and locations more useful.

17 Mason Gaffney, "Land Rent, Taxation, and Public Policy," *Papers and Proceedings of the Regional Science Association, 1968*, Philadelphia, 1969, pp. 149-50.

Land as a Product of Nature

Land as a productive resource resembles labor and capital in some respects but differs crucially in others. The similarities include the fact that parcels of land vary greatly in desirability as do human skills and machines. One outstanding difference lies in mobility-immobility. Space is immobile, other things mobile. Here is the one thing a local government can tax heavily without fear that it will move to a lower tax area. This is a tax which ought *not* to be neutral as compared with the burden on improvements. The reasons which argue for neutrality in taxation do not apply to the productive resource whose supply is immobile and inelastic.

Another difference between land and other things is the source of worth, the way by which values come into existence. Labor and capital, the vigor of human endeavor, entrepreneurship, the amount of machinery and structures, all these depend in part upon what individuals expect to get in compensation. And over time expectations depend upon the actual payments. To get productive capacity of these types, society must pay. Moreover, attempts of society to take back through taxes what it has paid for the service of capital and labor will affect the future supply. Not only the equity of high taxes but also the effects on what will be available in the future must be considered.

Land in the strictest sense is different. Nature created part of what we now pay for—but not all. As space on the surface of the earth, especially in cities, the amount of land in existence will depend scarcely at all upon the amount paid. The payment, however, does make a difference in what is actually available. Ownership permits withholding from use, thus depriving the community of the value of something created by nature. Rewards influence the kind of use. Occasionally, the difference between high and low payment will determine whether land is used at all or held essentially idle. Much more often, the amount paid will govern the particular use to be made of a location, its allocation among alternative uses.

Parcels of land, especially in their characteristics as space and location, do differ immensely. Therefore, something to help allocate and achieve most efficient use is of utmost importance to society. Payments for the use of land do perform a function of outstanding significance—allocation among alternative uses—but a portion of the payment will *not*, as for manmade productive capacity, also serve the function of *inducing the creation* of the productive resource.

Land as area is fixed in quantity. Tax it heavily, and it will not move to some other place, or decide to take a vacation, or leave the inventory of productive resources by going out of existence. Tax land lightly, and the favorable tax situation will not create more space in the community.

Our ethos apparently ties economic justice—equity—to rewards based on

accomplishment.[18] This principle does not lead to justification of "large" rewards because of the ownership of land. Differences, big ones, in payments for human services or for the use of capital can rest on what the recipients have done. But for the owners of urban *locations* such justification can rarely be found; when there have been private inputs for community development, to the extent feasible administratively, they belong on the tax rolls as improvements rather than as land.

Private Ownership of Land

Private owners have much control over how land is to be used, over the space in a crowded area. They can insist upon being paid for the use of this space. From decade to decade private owners who do nothing, or very little, to enhance the usability of land often get more in prices and more from occupants. Zoning and other governmental actions also materially affect prices of land.

What an owner can get in the form of land price increases in and around cities has made rich men out of owners of farmland, vegetable plots, and waste areas. More than one owner of a few acres of potato land on Long Island or farms on the outskirts of many a city in the United States, of a small plot of rice land near Tokyo or Bangkok or Taipei, has reaped handsome gains because of the pressure of population. In America, North and South, in Europe and Australia and Africa, private enrichment has come to the passive owner of land who has done little or nothing to enlarge its worth as part of the city whose growth has brought his good fortune. In fact he may have paid no more than an infinitesimal fraction of the taxes which have financed the streets and other governmental facilities that have helped to elevate the value of his land.

What strikes me in the present system is the amount of "unmerited" increases in land prices, despite rising tax and interest rates. Most owners today must be beneficiaries of increases in land prices. To withdraw some of these by taxes to finance local government would in itself not strike me as seriously questionable on grounds of equity, even if there were no reduction in the tax on structures. The overshadowing concern ought to be the longer run.

Concluding Comment

The equity aspects provide a strong case for shifting tax burdens from improvement to location values. Other reasons which I have not attempted to cover reinforce the arguments.

[18] As noted earlier, Americans, and as far as I know other peoples, get along without articulated consensus on the meaning of "justice," "equity," "fairness." In discussions of public policy, much fuzzy and wishful thinking, and avoidance of hard problems, gets mixed with good intention, high aspiration, and the most commendable of humanity. The results are not the sharp, clear guides which one seeks in judging alternative governmental policies.