Creating a better model to solve urban ills

How governments must change strategies to free productive sources in our economic system

By Edward J. Dodson

ACCORDING to various members of our government, the policies of the present administration have provided the catalyst and prescription for long-term economic recovery. The upward trend of certain "leading economic indicators" seems to substantiate such claims. What bothers me, however, is the structural nature of high unemployment levels.

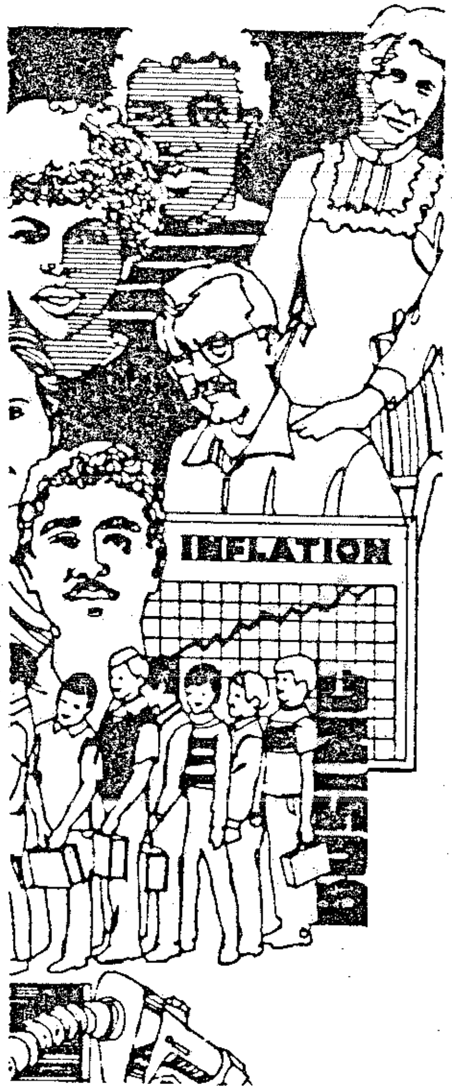
Government statistics conveniently measure unemployment only on the basis of how many individuals register for unemployment benefits. Absent is the actual number of people who are no longer eligible for unemployment benefits and have given up their search for work. Continued plant closings, permanent layoffs and wage concessions paint a different picture of realty for the worker.

Also looming over our economic future is the potentially catastrophic problem of defaults on institutionally-held debt by many financially desperate nations (accompanied and exacerbated by serious political upheaval). Further, we must also recognize that despite administration pronouncements to the contrary, inflation continues as a primary problem for the United States and the world economy in general.

Tragic aspects

This brief tour of our economic circumstances leads back to the very personal and tragic aspects of unemployment. The political economists continue to debate the causes of mass unemployment; however, simple observation reveals that once under way the process of recession has the capacity to feed upon its own downward momentum. Unemployment becomes more severe under conditions of reduced consumer demand and this triggers a secondary reduction in the demand for inventories and new plant or equipment, which leads to more unemployment, further reducing consumer spending, and so on.

As the cycle deepens there is normally a significant deflationary effect on prices, since the relationship between those who control the supply



of goods and services and the demand level is reversed. In a severe recession there is very little "demand pull"; therefore, suppliers committed to production are forced to compete via the price mechanism for a reduced number of buyers.

Faced with a growing level of structural (i.e., essentially permanent) unemployment here in the United States, the immediate concern is whether any combination of economic policies thus far practiced can produce growth and stability. For reasons too involved for this writing, I am convinced that the conventional approaches ("conservative" or "liberal") have contributed to the problems rather than helped them.

Thus, for somewhat different reasons I am in agreement with M.I.T.'s Lester Thurow that we have fallen to a plateau in economic growth. As a result, we are faced with a "zero sum" environment in which the world's net supply of physical wealth (i.e., real rather than monetary forms of capital) has virtually ceased to expand.

What we are experiencing is that through the process of deterioration nature is recapturing more of the existing capital stock than is being replaced by production. As a result, economic policy pursued by government, accepting zero sum conditions, is directed not toward unilateral growth but toward achieving comparative advantage over other political economies (whether at the urban, regional, national or international level).

Examine the players

To understand the nature and consequences of zero sum strategies, we must first examine the players and their respective strengths and weaknesses. Although they fall into four categories, one is hardpressed to identify a given player by one category only, as will become evident.

At the core of economic production are the players who control what nature has to offer (i.e., the land and natural resources). By virtue of ownership rights held against locations or resources, these players attempt to dictate the terms under which the economic factor "land" is brought to the game. For the landowning player—who might be an individual, corporation or government—the greater the control over the supply of essential land (e.g., a unique location near a major transportation hub or land blessed by plentiful fossil fuels or minerals) the greater the impact on the end distribution of rewards.

Custom has identified players in the second group: "labor." This group receives a monetary wage for its efforts. Economists, however, generally adhere to an expanded definition of labor as not being a class of individuals but as a "factor of production" (i.e., human exertion both mental and physical) expended with the production of physical wealth as a goal.

Under our complex system of indirect production and specialization, wages are returned to labor in the

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form of money which represents a contribution to the value of wealth actually produced. The actions of labor in the zero sum game reflect a recognition of imposed wage limitations, and labor attempts to obtain higher rewards not from greater production but by more aggressive bargaining through unions, which attempt to control the supply of labor in much the same manner as is land by those players controlling its supply.

Unfortunately for labor, large numbers make difficult such control; and, as the game approaches zero sum and goes beyond, previous gains in wages and other benefits are lost and employment itself becomes threatened. Part of the reason is that our first category of players (land owners) is far more capable of limiting supply and thereby sustaining price levels. Additionally, our third player has the responsibility of determining who plays (i.e., is employed) and who is left out of the game.

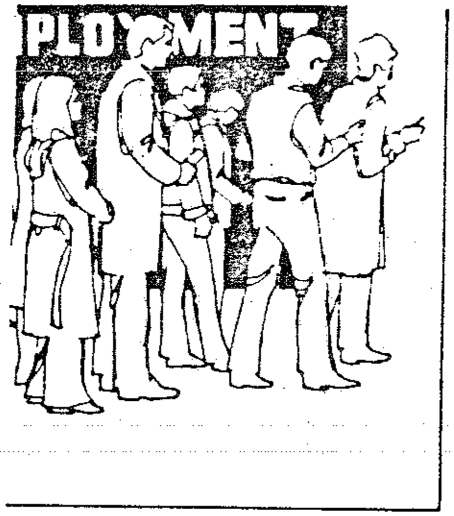
This third player is the business entity (anything from the single proprietor/entrepreneur to the publicly-held multinational corporation). How well the individual business entity fares in the game depends upon many factors, some recognizable and others well-concealed. High qaulity products and services, even expert management, will take our third player only so far. Success and longevity are directly tied to maximizing the cost/benefit negotiations with other players in the game.

The government

Therefore, the effective zero sum strategy is, on the one hand, to acquire as much control over your land factor needs as possible, while rewarding labor on the basis of profitability rather than production. Having accomplished this strategy, the business entity still has the problem of dealing with the last, and often the most powerful, player—government.

For better or worse, government has always maintained the role of removing impartiality from the market. The other three sets of players are to greater or lesser extents controlled or protected by government intervention. During the game each player attempts to introduce countervailing measures in an effort to neutralize advantages granted by government to opposing players. The result is a burgeoning government bureaucracy beseiged by pleas for advantage from a multitude of special interests.

The rules of the game may change overnight and without consideration as to long-term effects, as evidenced by the impact of O.P.E.C. in the game as a multi-government sanctioned



monopoly having both political and economic purposes. A decade of world-wide turmoil followed as the other players scrambled to introduce countervailing measures and protect their respective pieces of the economic pie.

As one becoms more convinced that th world economy has, because of existing structural conditions, reached zero sum, then the issue of comparative advantage becomes crucial as a strategy for short-run gain—not only in the international markets but between regions, metropolitan areas and even between the urban center and its suburban fringes.

What is needed, then, to compete successfully is a strategic plan based on policies necessary to achieve comparative advantage. While this scenario indicates a greater conflict rather than cooperation between recognized geographic units, such a program is vital for the urban center because of intense social problems associated with rising unemployment and loss of business activity. Moreover, as financial support from the Federal government is withdrawn the urban center faces tremendous revenue-raising problems for which it has historically been ill-equipped to handle.

The urban center today experiences the bitter pain of comparative disadvantage in the contest with wealthier suburbs. Suburban populations support business and government by a significantly higher level of per capita income and require far less in the way of locally financed social welfare programs. Additionally, since educational and job skill levels of urban dwellers are often rated by employers as inferior to those of suburban-educated workers, many employment opportunities located in the urban center are taken by suburban residents. While the city receives some benefit from the presence of these workers (tax revenue on wages, consumer spending, etc.), the bulk of their earnings—that spent on housing, food and clothing—is returned to the suburban community in which they reside.

Thus, although the urban population represents a vast pool of untapped labor which, if gainfully employed, would support thousands of large and small business entities, the same population unemployed acts as a tremendous drag on the urban economy. Government then further complicates the picture by using its taxing powers in an attempt to redistribute purchasing power from those who are producing to those who are not.

One can argue over the social and political need for such government intervention on the grounds of "economic equality" or "humanitarianism." Certainly, those disenfranchised from society because of structural flaws not of their own making must be protected. However, what is only now gaining recognition is that the consequences on the productive players of redistribution through heavy taxation eventually worsens the problem of comparative disadvantage.

This is because deteriorating urban markets and escalating taxes force many businesses either to close down for good or to move to a location outside the reach of the revenue-hungry urban center. Taken with them are both jobs and more of the tax base, and as the process accelerates the city inches closer toward fiscal, economic and social disorder. The issue is not *if* but *when* this will occur.

Reduce tax levels

The clear zero sum strategy for the urban center is to greatly reduce tax levels to a point where they have a comparative advantage over suburban competitor communities. Doing so will improve the condition of existing but marginally-profitable business entities and return to wage earners a larger amount of earnings with which to obtain goods and services.

Presented with new technologies and pushed by rising production costs, business has adopted a survival strategy of replacing labor with machinery. Many workers have lost their jobs due to the introduction of automation, but because we have reached zero sum they are unable to find other employment. Again, government policies such as accelerated depreciation and investment tax credits make investment in physical capital significantly more advantageous than employing more people. (In response, union leaders negotiate to protect workers from job loss due to auto-

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mation, and businesses simply do not replace those who retire or otherwise leave.)

And yet, as the number of unemployed increases, consumer spending drops and many firms end up closing despite efforts to "modernize." One strategy available to both business and labor has only been sporadically introduced and generally in watered-down fashion—employee participation in ownership.

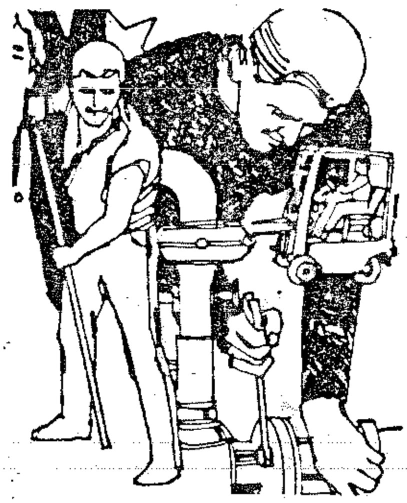
Through the efforts of California attorney Louis Kelso, Congress several years ago passed legislation supporting the tax-advantaged employee stock ownership plan ("ESOP"). This represents at least one way for business and labor to end the "us versus them" type of relationship so destructive to achieving comparative advantage. I am convinced that only by a gradual movement toward at least partial employee ownership of large businesses will investment decisions begin to reflect concern for both employment security and long-term growth.

Employee participation

The short-term profit maximization concerns of private investors/speculators differ from those of employee stockholders who, through reinvestment of pension fund monies and an ESOP, gain a voice in the management of the company and contribute to its monetary capital. Under conditions of employee participation, automation and modernization become positive and motivating factors rather than threats to employment. This is even more important where zero sum conditions dictate there will be more losers than winners.

Returning to the issue of tax policy, a legitimate question arises as to what would happen to government's ability to raise revenue if wholesale tax reductions were adopted. The relationship between significant tax reductions on wages, business income or physical capital and the beneficial impact is rather straightforward. What cannot occur, however, is an overnight response, since business investment decisions are made well in advance of implementation.

Consequently, the level of government services will stay high and so the need for revenue. Remembering that the implementation of changes in tax policy must be undertaken on a gradual basis to permit individuals and businesses sufficient time to react, the solution to the potential revenue gap dilemma rests with that factor of production and its controlling players not directly affected by the above measures.



What the city retains as its primary tax base is that which would be there even if all of its citizens and businesses decided to pick up and leave—the location of the city itself and the value of it its land.

As an economic factor, land is the one thing permanently fixed in location. It cannot be picked up and moved. Because of this characteristic, a gradual shift in the tax base from moveable factors (people and physical capital) to land values produces a set of business considerations that enhance the urban center's position vis a vis its suburban competitor communities:

- Owners of centrally-located and normally valuable sites would be able to realize substantial benefit by putting their land to intensive use. In anticipation to a gradual shift in the tax on real estate from one imposed on both land and buildings to land only, the property owner has sufficient time to consider the most advantageous development options in order to minimize the impact of the change.
- An unused or underutilized sites are brought into development, new employment opportunities would be created. An expanding employment base reduces the pressure on government to raise revenue for unemployment and welfare-related services and simultaneously broadens the tax base supported by wages, permitting a drop in the rate of taxation.
- Economic theory indicates that taxes on land values become capitalized into lower land prices, since the increased cost of carrying undeveloped land of high market value brings more land onto the market, creating more of a "buyers market" for land.
- The cost of tax collection drops significantly since a tax based primarily on assessment of land values is rather simple to implement using modern appraisal methods and computer equipment. Moreover, there exists in every urban center large quantities of unused land or sites cleared of improvements prior to development. The sales data for these sites would be inputed into the computer's data base and, based on location, zoning and other qualities, each parcel appropriately assessed. Such a computerized system (once full exemption of improvements is implemented) largely eliminates the inequitable nature of the present form of property tax and amalgamation of other taxes, plagued as they have always been by subjectivity, noncompliance and frequent fraud.
- Properly assessed land is also more likely to attract development based on its best economic use (as dictated by demand and in accordance with such community-imposed restrictions as zoning and availability of municipal services).
- Finally, investment and rebuilding in neighborhoods outside the central business district becomes economically feasible because the lower profit potential is reflected in proportionately lower taxes levied on less valuable land. Renovation and rehabilitation of older structures also would benefit unilaterally rather than piecemeal as is now the case under government-sponsored tax abatements.

The above strategies and proposed changes in tax policies address the issue of unemployment from a market rather than government-centered approach. From the above discussion, I hope the reader will recognize that government—by setting down the rules—has a strong say in who wins or loses.

While city government's responsibility is to improve the urban center's position of comparative advantage, the strategies proposed are designed to free the productive forces inherent in our economic system. Conventional wisdom has up to this point prescribed the opposite—restrictive tariffs, import quotas, wage and price controls and other types of heavy-handed government interference. Those methods brought the world economy to its zero sum position. An expansion of comparative advantage strategies beyond the urban center to the metropolitan, regional, national and international markets might put us back on a growth path and end the zero sum game for good. □

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