

# Incentive Taxation

## Seven Nobel Prize Winners Endorse Land Value Taxation

The headline is correct. If we had eight, would you be more impressed, and even more important, moved to action?

**Milton Friedman:** "I share your view that taxes would be best placed on the land, and not on improvements."

**Herbert Simon:** "Assuming that a tax increase is necessary, it is clearly preferable to impose the additional cost on land by increasing the land tax, rather than to increase the wage tax - the two alternatives open to the City (of Pittsburgh). It is the use and occupancy of property that creates the need for the municipal services that appear as the largest item in the budget - fire and police protection, waste removal, and public works. The average increase in tax bills of city residents will be about twice as great with wage tax increase than with a land tax increase."

**Paul Samuelson:** "Pure land rent is in the nature of a 'surplus' which can be taxed heavily without distorting production incentives or efficiency." A land value tax can be called "the useful tax on measured land surplus."

**James Tobin:** "I think in principle it's a good idea to tax unimproved land, and particularly capital gains (wind-falls) on it. Theory says we should try to tax items with zero or low elasticity, and those include sites."

**James Buchanan:** "The landowner who withdraws land from productive use to a purely private use should be required to pay higher, not lower, taxes."

**Franco Modigliani:** "It is important that the rent of land be retained as a source of government revenue. Some persons who could make excellent use of land would be unable to raise money for the purchase price. Collecting rent annually provides access to land for persons with limited access to credit."

**Robert Solow:** "Users of land should not be allowed to acquire rights of indefinite duration for single payments. For efficiency, for adequate revenue and for justice, every user of land should be required to make an annual payment to the local government equal to the current rental value of the land that he or she prevents others from using."

The current president-elect of the American Economics Association, **William Vickrey**, also endorses land value taxation: "It guarantees that no one dispossesses fellow citizens by obtaining a disproportionate share of what nature provides for humanity."

The endorsements from the last three economists named above were taken from a letter dated November 7, 1990 to Mikhail Gorbachev signed by 30 prominent U.S. economists.

# Responses to Objections

Every year, we publish an article which deals with commonly-held objections to land value taxation. Here is this year's crop.

(1) LAND VALUE TAXATION IS OK, BUT IT CAN'T BE THAT IMPORTANT BECAUSE LAND VALUES ARE NOT THAT IMPORTANT IN OUR MODERN INDUSTRIAL SOCIETY. ARE YOU NOT RAISING A TEMPEST IN A TEAPOT?

No: (a) If the locational value of land should be taxed, then do it, whether it collects a lot or a little revenue. It could require all sites to be used efficiently and this would create jobs, especially if labor and capital were un-taxed.

(b) A study we've done, based on Census Bureau data, shows that a locational value charge (or LVT) would raise 20% of the national income, based on conservative assumptions only. So it's no tempest in a teapot. While we dither, little children die, and adult lives are twisted.

(2) BUSINESSMEN PREFER TO PAY TAXES AND WOULD PREFER TO OWN LAND RATHER THAN RENT IT.

Concerning the first preference mentioned above, it is so ridiculous as to be beneath serious consideration; most businessmen would obviously prefer low or no taxes, which is what they'd get with the land value taxation (LVT);

The second objection (that businessmen would prefer to own rather than rent land) is more plausible, but it is not reasonable;

(a) With LVT, they would have the guaranteed option to renew at the market-determined rent, subject to a formal appeals process (a process not available to them if labor and capital were taxed). This should give businessmen complete security of building ownership (esp. if such buildings were not taxed);

(b) Few businessmen own the land they do business on;

(c) Under LVT, they would pay low or no taxes on labor and capital; isn't that good for business?

(d) The only reason to own land is to speculate in it (to want to sell it at a higher price some day than now), which is a disruptive privilege they're not entitled to.

(3) HOW COULD POOR PEOPLE OWN LAND UNDER LVT (LAND VALUE TAXATION)?

If land values are taxed, then land prices will be low, well within the reach of poor people. Wouldn't you pay less for land if it were taxed according to its value?

To be sure, land taxes would be higher under LVT, but building and other taxes would be lower, and speculative rent costs would be nil (with LVT, it wouldn't pay to speculate). So poor people could own land more easily.

(4) LVT IS SOCIALISM!

No. If land values were taxed, then it wouldn't be necessary for the government to socialize wages and return-on-capital by taxing them. If you like free enterprise, then don't tax it! Remember, under LVT private landownership would remain inviolate. Private deeds will still exist. In fact, land ownership would be more secure than ever since the uses to which you put your land would be un-taxed.

(5) LAND SPECULATION RESULTS IN THE EFFICIENT USE OF LAND.

Just the reverse. When land values are not taxed, land needn't be put to its most efficient (profitable) current use. The purpose of land speculation is to under-use a site -- not use it

efficiently -- in the hope of selling it at a higher price later. That's high inefficiency! But perhaps the land speculator is holding the site out of full use now until it "ripens" -- i.e., until the market says it can be used for a more intensive use, perhaps a shopping center. Once again, it's high inefficiency to keep a site out of its best current use, as can happen now. The "best current use" is measured by the site's market value (price). When an area needs a shopping center, it will get it, don't worry. If land values are taxed fully, it will become too expensive to use a site inefficiently. The non-taxation of land values leads to the premature urban sprawl into the clean-and-green countryside.

(6) APARTMENT TENANTS WILL PAY MORE WITH LVT.

Just the reverse -- they'll all pay less. There'll be less building tax to be passed on to them, and the land value tax is paid by the owner and cannot be passed on to the tenants -- every textbook agrees because the higher land value tax cannot decrease supply (which was fixed at Creation) or increase demand; thus, the land rent would be unaffected. In fact, since the available supply of land on the market will be increased (it would be too expensive to keep land in an inefficient use), there will be less (not more) of this cost for the landowner to pass on to his tenants. All tenants will benefit, including retail stores and office renters. Moreover, apartment and office building owners are among the greatest savers with a building-to-land switch in the property tax. Tenants would surely benefit from that.

(7) LVT IS NO PANACEA.

This is correct. There are no panaceas.

If you intend to have your city council approve a two-rate tax for next year, then you should start preparing now to do so. A number of cities contact us at the last minute, making a two-rate adoption more difficult. If you want more information on how to switch to a two-rate system, feel free to contact us at: 2000 Century Plaza (238) Columbia, MD 21044, 301-740-1177. Many officials in other cities have done so in the past.

## INCENTIVE TAXATION



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## From the Editor

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- Philadelphia's wage tax and other business taxes "really work like a force field repelling business location decisions," says Diane Reed of the Pennsylvania Economy League (*Phila. Inquirer*, 12/23/90). We agree 100%.

- Private building permits in the U.S. were up 1.22 times in 1980-88, much less than the increase registered by our two-rate cities during the same period (1990 USA Census).

- Economic growth was up recently in Harrisburg, Pittsburgh and Scranton, according to a report by the Alphametrics Corporation (*The Times Herald*, 7/16/90). Meanwhile, the city of Allentown's economic growth was down, placing that city 68th on a list of 75 metropolitan areas surveyed.

How interesting that the cities using the two-rate property tax reported economic growth while Allentown, which rejected the two-rate tax, is lagging behind.

- We appreciate confirmation: our LVT colleagues in Great Britain, after much care, have estimated that land rent there is 22% of national income - about what it is here (see Ronald Banks, et al, *Costing the Earth* [London: Shephard-Walwyn], 1989, 195 pp., \$12 from C.S.E.).

- Of course we should have a Yukon-to-Yucatan free-trade zone with Canada and Mexico, but too much of the benefit will go to landowners rather than to producers (labor and capital).

- Property tax abatements are an important incentive in high property tax localities, according to a H.U.D. study ("A Study of the Effects of Property Tax Incentive Programs Upon Pty. Rehab. & New Construction," 1973, p. 4, brought to our attention by IT reader and Community Development Director Gary Carlson).

- Property taxes were 39% of state and local gov't revenue in 1970, 30% in 1988 (U.S. Census Bureau).

- "Skyrocketing land prices" are cited as the primary reason why so few Japanese families are deciding to have children (*U.S. News & World Report*, 12/24/90, p. 57). The economic stress caused by land price inflation has caused Japan's population growth to fall to an all-time low.

- Despite the mountains of evidence we have accumulated that a building-to-land shift in the property tax always spurs new construction and rehabilitation, only 15 cities in Pennsylvania have adopted 2-rate so far (though more are on the way). It is a little disconcerting, even discouraging, but of course we will persist....

- "Since 1984 Illinois law has allowed a hard-pressed older homeowner to defer payment of property taxes until his death, at which time they are paid as part of the settlement of the estate; however, the Illinois Department of Revenue reports that fewer than 300 people took advantage of that program during the 1989 tax year" (Krohe, *Chicago Enterprise* magazine, 4/91, p. 24).

We would prefer that only the part of the tax he can't pay be deferred, not the whole.

- America has 230,000 bridges in desperate need of repair (Aaron Sugarman, journalist on ABC Good Morning America, 8/27/91, 8:10 a.m.). We presume those bridges increase the locational price of land, so shouldn't the cost of repairing them come from a land-price tax? Otherwise, there'll be windfall subsidies to landowners and heavy tax burdens for taxpayers.

- In Philadelphia, 46% of all homes could be afforded by a family with the local median income. In two-rate Pittsburgh, the corresponding figure is 65% (item from the *Philadelphia Inquirer*, 5/26/91-4J, sent to us by IT Reader Edward Dodson).

- More than 50% of new mothers return to work outside the home before their child's first birthday (Population Reference Bureau).

IAAO Manual ("Improving Real Property Assessments," p. 198, 1988): "Urban economists and city planners have long recognized that the general underassessment of land tends to promote inefficient land use and undesirable growth patterns."

### *Does LVT Increase Tax Defaults?*

*(Because tax default is an argument against land value taxation which lately we have heard frequently, we reprint the following article from our September 1983 issue. We have often published articles giving empirical evidence for similar conclusions):*

Whenever the subject of land value taxation (LVT) is broached, the question of tax default is often raised. Would such a tax increase the amount of property taken over by the government because of tax non-payment? We inquired of Godfrey Dunkley, South African land researcher, about this matter and he replied (letter of 2/26/83):

"The question of default in payment of rates [property taxes] where land value taxation applies is almost unknown here in South Africa. I asked Mr. S.J. Venter who is now president of the Institute of Municipal Treasurers and Accountants. He has been treasurer of one of our cities, Roodepoort, for seventeen years. In his experience there have only been two cases where land has been sold to defray outstanding rates; both insolvent estates."

South Africa's experience duplicates that of Australia where many cities tax only land values but have no more cases of tax default than neighboring or comparable cities which tax buildings also. In fact, studies show their number of defaults is even slightly less.

### *Whatever You Tax - Disappears*

Whatever you tax, disappears:

- tax buildings, and fewer will be constructed and maintained,
  - tax wages, and fewer jobs will be created,
  - tax retail sales, and they'll disappear because consumers will have less after-tax money,
  - tax imports (tariffs), and they'll disappear because they'll be more expensive; exports will also disappear because if our potential foreign customers can't sell to us, they won't buy from us,
  - tax land prices, and they'll also disappear, but that'll be good because with cheaper land, more people will have access to Nature's opportunities; they'll produce more.
- Let's tax locations rather than production.

**Australian Building Industry Congress:** "As an immediate and practical step, Congress recommends the abolition of municipal water and sewerage rates (taxes) upon buildings and improvements, and that rates be based instead on the bare-value of the land."

### *If You Want To Take Action....*

This organization has had much experience with cities which already levy a tax on the selling or rental price of land:

- We have worked with all 15 cities in Pennsylvania which have adopted a two-rate property tax (a higher tax rate on land assessments, lower on buildings).

- We have worked, or are currently working, with other cities contemplating such a change.

- We have done research on this matter for over 40 years. There are about 2,000 cities worldwide.

- We have specialized in methods to ensure that a land value tax (or alternatively, the government collection of the annual rental income of land) will be politically popular; this can be done by alleviating special hardship cases.

Before a government contemplates switching to a land value tax, it might want to take advantage of this expertise. If anyone needs more information (at no obligation), they could write or phone us at 1-301-740-1177, or fax us at 1-301-997-1608.

### *Self-Supporting City*

*From an article by Perry Prentice, former vice-president of Time, Inc. entitled "Taxes and the Death of Cities":*

"A recent study in Montreal came up with this fascinating statistic: if landowners in Montreal had to pay the city 5 percent interest on the city's investment in those community facilities without which their land would be unusable and therefore worth almost nothing, then the city could run its government and operate its plant without collecting any taxes at all!"

#### **Center For The Study Of Economics**

2000 Century Plaza • Suite 238  
Columbia, Maryland 21044

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