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Mr. Robert Clancy, Editor
Georgist Journal
Henry George Institute
121 East 30th Street
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Re: Markets / Regional and Global

Dear Bob,

The exchanges between Fred Foldvary and Ian Lambert highlight the complexity of markets, a circumstance that frustrates efforts to quantify with certainty what is occurring (particularly over the short and intermediate terms). How this debate relates to Henry George's political economy, it seems to me, is two-fold. First, is the ongoing assessment of George's closed system of production and distribution and whether the laws he developed really do explain what happens in the real world. What we must remember is what George understood; namely, that these laws are driven by human behavior and, as laws of tendency are distinct from the physical laws of physics that govern the interaction of matter in the Universe. Moreover, the power of externalities to influence, halt or redirect our behavior is not only great but constant.

Ian indicates that his primary objective has been to support the conclusion reached by George that the natural tendency of wages is to hover at subsistence. He does this by using available data and statistics to suggest that real wages (i.e., the purchase power of nominal wages paid in legal tender) have not really increased over time. Global statistics give a mixed picture; however, the most powerful examples in support of George are found in countries where population growth has not been matched by the adoption of participatory government, widespread education and medical care or some degree of equity in taxation. Fred seems to have (as do I) a lot of trouble with this concept of *domestic rent* that Ian has come up with. I think the most important observation Fred makes is that "[e]very good or service one buys has a rent component." For those who are quantitatively-oriented, the challenge is in determining just what that rent component is -- given the fact that a very high percentage of the goods we use are produced part by part, often in different countries, then shipped to intermediate assembly plants, reshipped for final assembly by distributors, retailers and often the ultimate consumer. One might conclude that the global economy creates a nightmare for microeconomists. We know that the globalization of production has frustrated the efforts by governments to impose taxation based on the locations at which revenue is received and profits earned. Transnational corporations are several steps ahead of the taxing authorities when it comes to the transfer of inter-company revenues and costs. Ian can correct me if I am not reading him clearly, I see the nature of the problem he raises as being associated with imputed rents that are not accounted for.

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In the financial industry there is a major debate waging that relates to imputed rents. Accounting practices have traditionally listed the nominal value of assets at cost. When assets are sold, a gain or loss is recorded as extraordinary income or loss. Because physical assets are generally illiquid, changes in value are not easily determined. Reappraisals are expensive and time-consuming. The circumstance surrounding financial assets is quite different; the value of stock, bonds and loan receivables change daily with the financial and credit markets. There is now in the United States increasing pressure on financial institutions to move to what is being called a *mark to market* basis of asset valuation. Regulators argue this would provide a much more accurate picture of an institution's financial strength or weakness. A natural extension of this concept is, of course, requiring business owners to have their landholdings reappraised periodically. The question remains as to whether this change will tell us much about the extent and direction of the movement of rent. The same sort of question arises when we look at land prices generally; in a market economy dominated by purchases and sales as opposed to leaseholds, calculating the full rental value of land is an exercise in futurity for anyone seeking specificity. I will try to explain why this is the case.

At the simplest level of calculation, we know that what drives investment is a combination of anticipated cash flow and appreciation. Investors weigh alternative investment opportunities on the basis of the greatest potential return based on acceptable risk. What constitutes acceptable risk is something distinct to various classes of investors and whether they are prohibited from taking on certain risk by charter or regulation. Wealth concentration has created a relatively small number of individual/family investors able to take a very long-term view. Some corporations involved in real estate development will acquire farmland they believe is in the natural path of an area's residential and commercial growth, then lease the land back to tenant farmers for far less than the true market rental value. By doing so, the land generally remains zoned agricultural and is valued as such for tax purposes. The developer does not really care whether the fertility of the soil is degraded; moreover, the difference between the rent collected and full potential rent (for agricultural use) is inconsequential. In the short-run the tenant farmer is benefiting from low land costs, receiving imputed rent as part of the total revenue generated by the sale of production. The cost to society is that the land is not brought into its highest and best use.

Obviously, the market price for this land has no relation to a capitalization of rent by the rate of return obtainable from alternative investments. Very many externalities contribute to what the owner would accept as an offer for purchase -- not the least of which is the owner's own financial reserves, weighed against the annual carrying cost of holding, weighed against the rate of appreciation and the owner's confidence in the longer-term average rate of appreciation and other intangibles. For most businesses, however, their landholdings are not viewed as a source of future revenue but as part of their start-up costs. As reason would suspect -- whether we talk about housing, warehouses, commercial, office or retail space -- the first group to experience squeezed profit margins are those who lease their land and their facilities. They have no reserve of imputed rent. If they acquired their space at the right time (e.g., when vacancy rates were high), they may have a long-term lease that limits escalations.

So, then, with all this complexity going on, how would an assessor come up with the potential rental value of any given site for purposes of taxation? Do we really need to have a widespread leasehold market to use as the basis, or will the rate of taxation impose an inevitable downward pressure on the selling price of land? All things being equal, I believe the Laffer Curve provides the answer. The rate of taxation should be gradually increased until that point where any further increase yields less revenue than previously. At this point, the taxes collected will have equalled even the speculative rental that deep pocket investors are willing to pay to gain access to given sites even though they do not plan to use them right away.

Sincerely,

