Working Paper

PRIVATIZING LAND WITHOUT GIVEAWAY

Embracing Capitalism without Kleptocracy

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Delivered at Conference on Social Collection of Rent in the Soviet Union[1]

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[1]Edited collection to be published 1991, edited by Nicolaus Tideman and Adele Wick.

"I … can no more call myself an individualist or a socialist than one who considers the forces by which the planets are held to their orbits could call himself a centrifugalist or a centripetalist." -- Henry George

I. An Emphasis on Synthesis

Westerners rightly rejoice in the apparent conversion of Soviet leaders to free market ideas. We take justifiable pride in the relative success of Western capitalism. Modest pride is sufferable; smugness and arrogance, however, are not. Let us therefore linger on the word "relative," and temper pride with self-analysis and humility. It is a time to reconcile, not strut and gloat. This writer does not favor trying to remold the economy of the U.S.S.R., or any of its breakaway nations, exactly in the U.S. image. It is with great nations as Emerson said of great men: "they leave no class. He who is really of their class will not be called by their name." Great nations do not just imitate, but adapt as they adopt imported ideas, merging them with their proper native genius.

Each nation has something to learn from the other. Western capitalism has scored many successes worth emulating, but others may learn from our failures, too. Recurrently with us are the same old unsolved problems that alienated Marx in the Gilded Age, and alienated many Americans who later turned to populism and the Progressive Movement, and Britons who turned to Fabianism and the Labor Party. The same problems later terminated the New Era of the Roaring Twenties and brought on the New Deal. History repeats: excesses of the acquisitive, profligate ’80s may soon generate another such reaction.

Some of our unresolved problems today include rising homelessness, the counterpart of low affordability of housing. This problem persists in spite of massive subsidies and tax breaks for housing that make America "overhoused" next to, say, Japan. Unemployment persists. Income and especially wealth are distributed with increasing inequality. American industry grows obsolescent faced with foreign competition: replacement is too slow, as in later 19th century Britain. Britain then at least saved and exported capital, but America's net domestic capital formation is dangerously weak, leading to capital imports and alienation of American wealth. Real wage rates are level or falling. Crime rates are frightening, with many Americans choosing to live in an underground economy. Anomie and substance abuse are everywhere. National security hangs on precarious foreign oil. A large piece of our financial system has just collapsed, and the rest looks shaky. There is much to be humble and concerned about.

Western capitalism has shown the world that "personal interest is the irreplaceable motive power of production and progress."[2] Let us trumpet this showing with pride, and preach to the world. Let us also allow that personal interest can, if badly handled, lead to inhumane excesses and abuses. A worthy goal is to combine capitalist drive and efficiency with socialist egalitarianism. How? Synthesis does not mean some vaguely compromising "middle way," but the best constructive combination of workable elements from each way. The specific centerpiece of policy proposed here is social collection of land rent, coupled with private collection and retention of incomes drawn from labor and from creating capital.

II. Reasons to Socialize Land Rent

Few now question that the land of the Soviet Union belongs to the whole people, through their governments. It is public domain, just like federal and state lands in the United States, and crown lands (federal and provincial) in Canada. (We do not here address the tortured topic of *which* constituent government owns what lands, a matter for citizens of the lands at issue to decide for themselves.) The question here is why and how to assert the common ownership of land by having government collect land rents to support its public functions.

A. Financial Reasons to Reserve Rent as a Tax Source

A simple, fast method of privatizing public land is selling fee simple title to the highest bidders, free and clear of reserved sovereign taxing rights. Selling is not abandoning or giving away the public equity in land, but exchanging it for cash up front. Why not sell, get it over with, and let the market work its magic from there?

Many American economists push this policy when advising how best to privatize or lease[3] public domain lands at home, especially since 1980. Without denying the prior public claim on ground rent, they sincerely see cash-up-front as the best way to assert the public claim, and thenceforward free the market from the meddlesome hand and irrational mind of government.

There are, however, many reasons to reject the policy of cash sales without credit or other deferred payment:

1. An entire nation cannot be sold off quickly at other than fire-sale prices. Mass privatization is a way of securing the worst possible bargain for the public selling the land.

Selling even a large bloc of land anywhere depresses prices, unless the proceeds are concurrently reinvested in nearby lands. A massive nationwide sale could only be a giveaway. Normal yearly turnover in the U.S. land market is 3% to 4% of parcels, and much less than 3% of value (because small parcels turn over faster). Most of even that small turnover is zero-sum, buyers being financed by sales of what they owned before. Net movement of money in or out of

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[2]Paraphrased from Viktor Chernov, secretary of agriculture in the provisional government of Aleksandr Kerensky.

[3]In respect to writing mineral leases on the OCS (Outer Continental Shelf), the issue presents itself in the question of whether to demand payment up front (the "bonus bid") or over time (delay rentals and royalties).

land is a small percentage of total value turned over, and a minuscule share of total land value.

Dumping all land in any short period, when that means finding new buyers to put new money into land titles, is unthinkable. The first small share of land sold would soak up all available capital funds, leaving none to buy the rest, let alone to finance development, improvement, and working capital.

Some economists point out there are plenty of hoarded private rubles to spare. Land sales, they believe, would "soak them up," thus in one stroke forestalling inflation, rewarding past abstinence, honoring a species of national debt, and getting a good price for land. That solution is illusory. Such rubles are just paper, not real wealth. To soak up the money and honor and retire the debt, the rubles received would have to be destroyed. Following that operation the seller would have no lands, no rubles, and no source of tax revenues.

The state would have reduced its "debt," it is true, if outstanding rubles be properly regarded as public debt. However, the conditions of the exchange would be such as to downvalue the lands given, and revalorize and validate the "debt," much to the disadvantage of the state and the bulk of citizens it represents. It is hard to see why the past generation had any right to alienate lands that are the birthright of present and future generations under any circumstances, let alone such disastrous ones.

Alternatively, after the sale, government might spend the paper rubles, but then it would not be repaying the "debt" they represent. The net effect on price levels would be much like financing government with newly printed money. In a nation perched on the edge of major inflation, that seems unthinkable. In spite of the suffering, it would not raise the real price fetched for land. Real prices are paid in real labor and real goods.

Germany faced the same problem in 1948 as it struggled to emerge from years of suppressed inflation and reconstitute a workable market economy. The currency reform of that year simply repudiated the old marks: draconian perhaps, not fair in every case, but better than any alternative and highly effective. It is doubtful if the ensuing *Wirtschaftswunder* would otherwise have occurred.

2. In a massive general land sale, most land would be bid up by a small number of buyers with surpluses of "patient money," many of them looking toward use or resale in the distant future. These buyers are the kind stigmatized as "land speculators," for their traditional indifference to highest and best current use of land.

To be sure, standard neoclassical microeconomic theory today hardly allows for such market failure. This theory is based on a priori deduction from unreal axioms selected to idealize market performance. Indeed, standard-brand theories hardly allow the existence of land as a factor of production with distinctive qualities, and are of limited use in predicting real behavior, and especially in finding departures from perfection.

The evidence of land market performance may be found instead by looking at facts, like the 19th century history of federal land disposal in the United States. This is documented at length in many works like those of Professor Paul Gates, Cornell University historian. The lag between sale and beneficial use of land was often measured in decades.

3. A government selling land, even at fire-sale prices, would be swamped with cash flow. Humans being what they are, these flows would be regarded as current income, and dissipated accordingly. Again, consider the use of national land sales in the United States in the 19th century. They were used in lieu of current tax revenues, to meet the operating expenses of government.

4. Governments need revenues in perpetuity. If they abandon land as a source of continuing revenue they must resort to other sources, typically taxes on sales and consumption (like those that helped trigger the deposition of Czar Nicholas II in the first place). Most taxes on tax bases other than land are of the nature that "shoot anything that moves," with the familiar effects of depressing production, misallocating resources, promoting underground and criminal economies, and lowering capital formation.

5. Private wealth being scarce in most Soviet republics, wealthy aliens would prevail in bidding for much of the best land. It is doubtful that any nation can long keep its sovereignty, or meaningfully represent its own median citizens, when most of its real estate is foreign-owned. In pre-commercial times one could own land in most countries only by swearing personal fealty to the sovereign from and under whom the land was held: that's why it's called "real" (from "regal") estate. Kings knew the link between land and power. Alien ownership was common only in conquered lands: it was the means of dominating, controlling, and exploiting their people.

Sovereignty supposedly remains with the resident voters, but only the deaf and blind are unaware that money and property swing elections, and the state and the law acknowledge and—some would say exist to—uphold the superior rights of property. In 1978 a watershed constitutional change, Proposition 13, was made in California. Although much California property is owned outside California and the United States, the successful campaign for Proposition 13 was propelled by the slogan "Property should only pay for services to property, not to people." That is a current version of the old contract theory of the state, whereby government is basically an agency contracting to serve landowners.

Foreign ownership invites foreign invasion of sovereignty. Witness the foreign extension of the American "trading-with-the-enemy" act, applied to U.S. corporations holding property in other nations. Witness the long-term effects of Zionist land acquisition in Palestine. Witness the Canadian law, only recently repealed in British Columbia, whereby real estate as such had so many votes, based on valuation. Witness the property basis of voting that prevails in most public water districts in California. Witness the long history of gunboat diplomacy, and latter-day CIA manipulations like the replacement of Mohammad Mossadegh by the shah of Iran. History shrieks: buying land is not just another commercial transaction, as the abstract theorists would

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Some believe that taxes on retail sales promote saving and hence capital formation. This overlooks wealth effects, and is dismissed below under the discussion of "functional reasons" for taxing land rents.

The notable exception to this rule is the "Wright Act Irrigation District," discussed *infra*.

have it. Landownership is political power.

6. The land market works better, on an ongoing basis, if land remains subject to regular taxes or other charges in perpetuity. Regular taxes, firmly anticipated long into the future, hold down present market prices by the amount of the capitalized taxes. This is a specific, visible instance of what it is now the fashion to call the "Ricardian Equivalence Theorem."

What avails the trade-off, to buy land cheaper, only to pay more over time? Median buyers are much better able to pay over time than up front. The effect is the same as financing all buyers, and so doing without credit discrimination as to rate of interest or other terms of lending. It removes all forms of credit rationing as factors in the land market, at the same time that it automatically meets the new buyer's greatest credit need, financing for the purchase of land. It yields all those benefits not just once, but for every succeeding generation of buyers in perpetuity.

The same force that helps the median buyer, conversely, inhibits the "strong-handed" speculative buyer who esteems land more as a store of value than as a factor of production, who grasps simply to be grasping, or to place surplus funds where they will keep with minimal care. A land tax stings the sleeping owner who clings to lands from inertia and lassitude, and bids him or her release them to youth and enterprise. It legitimizes and supports property only as a means to produce wealth, not property for the sake of property. It penalizes pure possessiveness. It overpowers the ancient vice of self-justifying acquisition, the *auri sacra fames* of Virgil, the "droputty, droputty, droputty" lampooned so mordantly by Alfred, Lord Tennyson, the *Absentee Ownership* savaged in Thorstein Veblen's final testament, the landlordism searchingly psychoanalyzed by Leo Tolstoy and Russian populist novelists of the 19th century.

7. Counterproductive rent-seeking behavior, in the most primal sense, is maximized when land is simply privatized without the state's reserving substantial servitudes, especially tax power. Private rent-seeking, the prime cause of legislative corruption and logrolling, would then dominate the planning, timing, sizing, and location of infrastructure of all kinds.

8. Local governments, traditionally undernourished and weak in much of the Soviet Union, also need revenues in perpetuity. It is possible that strengthening local governments to provide

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The writer does not endorse most current usages of the Ricardian Equivalence Theorem. It presumes most wealth owners are fully aware of all public debts, and foresee the future tax implications thereof. The verifiable fact is, most taxpayers are only aware of debts indirectly, via their current taxes; and only taxes on land are clearly capitalized into lower values.

The point is developed in Mason Gaffney, 1969, "Economic Aspects of Water Resource Policy," AJES 28(2):131-44 at p. 133. See Appendix to this chapter. (Nic: I enclose relevant pages, am happy to accept your decision whether to include.)

"Northern Farmer, New Style."

local micro-infrastructure would fill nearly as great an unmet need as the development of a private sector itself. Local government only thrives with its own proper revenues.

9. A means is needed gently to pry loose surplus land from state agencies like ministries in charge of production. Forcing sale of surplus lands would be drastic and unlikely to be broadly implemented, for the same reasons the death penalty is not widely used. It would be reserved for extreme, flagrant cases after long review, appeals, and delay. The alternative of ongoing land taxation, *without exempting state agencies*, is more workable in practice. Taiwan affords a precedent.

The Soviet republics may regard lands as common, but not as "commons" in the sense of open range. They are not starting from that kind of clean slate. Land is tenured. It is controlled by existing agencies that are just as possessive and righteous as the U.S. Forest Service and the University of California (54,000 acres and more, all used "for educational purposes"). These agencies have important core functions. The No. 1 priority in privatization is to induce them to identify and sell their surplus lands, while retaining and better using their essential lands (the university, for example, might focus more on research and teaching, rather than land speculation).

10. Public acquisition of lands for such uses as rights-of-way (r.o.w.), schools, reservoirs, air bases, parks, and watershed protection becomes much more costly when all land is privatized first.

What about selling movable property, like inventory and machinery, owned by state enterprises? Here the objections to selling for a single up-front payment are far lighter. The mean residual economic life of modern industrial capital is only a few years, and the selling price is a correspondingly low multiple of cash flow. Thus, purchases are self-liquidating in a few years or, with many inventories, just a few months. Financing purchase is, accordingly, much easier for borrowers, and requires much less money, than financing land, whose price is a high multiple of cash flow.

Buyers of durable structures affixed to land generally want financing; we do not belittle the need. We do stress, however, that financing structures is easier when buyers need not also finance the land under them. There are, in fact, many instances of sellers' broadening their markets by selling houses separately from the land.

B. Functional Reasons for Taxing Land Rent

1. Taxing land allows us to avoid taxing functional activities like production, exchange, work,

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W.S. King, "Land Value Taxation in Taiwan: Present Status," in Isaac Ofori (ed.), *Real Property and Land as Tax Base for Development*, 1991 (scheduled), Taoyuan, Taiwan: Land Reform Training Institute.

The multiple is high because the future life of land is infinite, and its cash flow (rent) is even likely to rise over time.

saving, and investment. Taxing productive activities has counterproductive effects, certified by expert economic testimony.

2. Taxing land holds down its purchase price, thus easing and democratizing entry. The financial problems described above under heading "A" are thus minimized or eliminated.

3. Taxing land drains cash from sleeping owners of surplus land, arousing them in the most compelling way to the otherwise overlooked opportunity cost of their surpluses. A cash drain has wealth and liquidity effects that are demonstrably more potent than mere "opportunity cost" in driving land to its highest and best uses.

4. Taxing land motivates sellers and moves the otherwise torpid land market. Standard-brand market theories implicitly envision a flow of commodities, readily turned up or down with changing demands, constantly consumed and replaced, easily divided or assembled, moved at will from here to there. Land does not fit the model. "So much the worse for land," pedantic theorists seem to say, but our realistic concern is with life and the facts that the models do not fit. The models' bright promises of competition working smoothly are not borne out by experience with land. It takes a strong extra push to make land markets work: land taxes provide that push.

As Harold Groves put it, land is not a stream from a fountain, it is the fountain itself. Land is fixed in place, easily subject to local monopolization, slow to be divided, arduous and costly to assemble, and tempting to hold in reserve. Most land lasts forever and is accordingly bid up by a wealthy few who seek a store of value for the distant future. This strong competition, usually with speculative overtones, makes land unaffordable for median buyers seeking to meet ordinary needs of the present.

5. Taxing land promotes markets by pushing central urban land into commercial uses yielding high cash flows. "The market" is not just an idea or a way of organizing the economy; it is a place, a land area dedicated to exchange. Taxing land inhibits most non-commercial uses in all those locations having high potential commercial value. It by no means destroys non-commercial uses, but relocates them to less central places.

6. Taxing land discourages the motives, currently powerful and dominant, to hold land mainly as a store of value and hedge against inflation. It also discourages landowners from their current practice of borrowing money and then joining and leading the too-powerful pro-inflation lobby.

7. It is arguable that taxes on bases other than land are largely shifted to—that is, are drawn from—land rent anyway. That is the "Physiocratic doctrine" of tax incidence. It presumes an open economy: labor and capital migrate freely across the borders. Given the premise, it follows that after-tax wage levels, and rates of return on capital, are fixed by world market forces. Local

taxation can only affect land rent.

With closed borders, the Physiocratic rule still applies in part. In either case a prime reason for singling out rent for direct taxation is that it is simply a more efficient means to socialize rent. Tax shifting always implies some friction and loss of taxable surplus: "excess burden" is the standard term.

This reasoning also gives us a new, expanded insight into the adequacy of land as a tax base. Under Physiocratic doctrine, land rent and taxable surplus are nearly coterminous.

C. Ethical Reasons for Taxing Land Rent

Once land titles are privatized, unearned gains and losses begin accruing immediately in this dynamic, complex, stochastic world. Expectations change daily; unforeseen windfalls and wipeouts based on exogenous, uncontrollable forces soon take over from original expectations that formed the basis of initial bids and sales prices. Surprises are inherent in land markets because land is irreproducible, permanent, and stationary.

Professor Thomas N. Carver has divided all incomes into "Earnings, Findings, and Stealings." Historically, most, if not all, land rent has been secured by stealing, that is, by force of conquest in the manner of Iraq taking Kuwait, Cromwell taking parts of Ireland, Spain taking the Philippines, Captain John Mason massacring the Pequods to take Connecticut, and so on. There is a lingering presumption of unsanctity about landed property.

On the other hand, if buyers in a truly free market paid government up front the full present value of land, one could regard future land rent as an honest "earning" on their early payment to the general fund. That view prevails among landowners and their economists, *ex parte* to be sure, but still arguable. Even from this perspective, however, there soon arise windfall rents that are "findings." Such findings are just as nonfunctional socially as stealings based on force, covin, and fraud.

A major source of such "findings" is new infrastructure that brings benefits to specific lands, and may remove them from others. In the Soviet lands, shifting from one political-economic system to a radically different one will entail massive changes of infrastructure—for example, providing micro-infrastructure like road and utility extensions for the many small private farms expected to supplant the present few giant collectives. Giant landholding units, both farm and industrial, typically have provided internally for much infrastructure that must now be provided publicly, no doubt with new plans and layouts.

The point is developed at length in Mason Gaffney, 1970, "Adequacy of Land as a Tax Base," in Daniel Holland (ed), *The Assessment of Land Value*, Madison, The University of Wisconsin Press.

This would presume fair prices, arms'-length dealings, equally well-informed buyers, land market not depressed by dumping, funds paid in good cash and honestly earned, absence of credit discrimination, and so on. Those requirements are more severe, and less likely to be met in practice, than a brief recitation may suggest. For example, the ancestors of many Americans now living were slaves when most of the public domain was sold off to others. The slaves hardly had an equal chance at it.

The capital to finance this infrastructure now lies sleeping in the lands to be served, whose rise in value will more than cover the costs, providing the projects are well planned and executed. To be just, however, the land gains must be tapped to pay the cost. If they are not tapped, the result will be the unethical process of someone else's paying to give the landowners a windfall.

Some lands are occupied by squatters. When these lands are privatized and tenured, removing the squatters poses hard ethical choices. Should they be given a prior claim to own the land they occupy? With a land tax that problem is *de minimis*: the state may give them titles but then require regular land tax payments to keep them. All buyers are more able to pay over time than up front. Many squatters could pay that way, too: the effect is the same as extending credit to these poor risks on the same terms as to the best. The inevitable nonpayers can be evicted selectively, leaving most squatters undisturbed.

D. Political Reasons for Taxing Land Rent

To unify a nation it makes sense for a central government to tax the rent from richer regions, those with more rent per capita, and distribute it nationally as some form of social dividend. Distribution should be on a per capita basis, and/or some surrogate basis like average daily attendance at school, military service, or social security entitlement. Nothing else that is purely economic seems as well calculated to give every citizen a birthright and stake in the nation.

On balance this policy helps overcome ancient ethnic loyalties and particularism. One must concede it may be resented by local landowners in regions of high land value per capita, exemplified by the province of Alberta, Canada. However, local distribution of superior local rents—in money or superior public services—is of no lasting advantage to the bulk of local people. The gain is quickly offset by competition from immigrants drawn by the higher social dividend. Such migration is also socially wasteful.

National distribution of rent, by contrast, has a great efficiency advantage along with its political advantage. Local distribution mislocates the population by over-attracting immigrants to the favored local polities, much as footloose people are now drawn to Moscow. National labor resources are wasted when people work at jobs of low productivity in order to enjoy the supplement of superior local public services. The efficiency advantage of national distribution can be made a political advantage because it raises national output for the gain of all.

The alternative method of distribution, "regional equity," sets an implied goal of equalizing rents among regions or local polities, rather than among individual citizens. Regional equity says, in the extreme, that every cow county deserves its own Grand Central Station or JFK Airport to compensate for its inherent geographical handicaps. It is a proven, historically certified recipe for dissipating rent and impoverishing rich states and nations. It may also be used as a cloak for costly, irrational imperialism, a way of clinging to distant, submarginal marches whose maintenance and demands exceed all possible economic, military, or political gains.

Distribution to local governments is also a formula for aborting their development as quasi-independent sources of power. Such quasi-independence within a nation is needed to balance central power and check despotism. Early U.S. federalism had some praiseworthy features (I do not refer to modern "revenue sharing"). Sovereignty was shared between central and state governments ("territories," earlier). States then set up counties, generally on the principle of *nulle terre sans seigneur*, that is, without leaving much land unorganized and hence untaxed. The states' power of taxation was delegated to counties and later to cities as they organized.

A key factor is that little aid (other than military) was passed from central to local governments as such. Local units had power to tax property, and they used it. They had little effective power to tax anything else. In this way, decentralized political power grew, saving the United States from the evils of overcentralization that beset, for example, its neighbor to the south.

III. Methods of Collecting Land Rent

A. Leasing vs. Taxation

Leasing and taxing are alternative methods of asserting public equity in land on an ongoing basis. Most taxes are closely analogous (and often homologous as well) to corresponding standard lease provisions.

Taxation possesses one quality, however, that makes it much preferable to leasing in general. That is the annual revaluation of rent and/or land value, based on current information derived from comparable parcels.

Leasing, on the other hand, binds the lessor to fixed terms contracted in advance. This practice is inherently biased for lessees, especially those who are "judgment proof," who can often walk away from an unfavorable lease with minimal real penalty. We are not too far off the mark to view a lease as an option for the lessee to use land provided its economic rent turns out to exceed the contract rent, and to abandon it otherwise.

In addition, private lessees, being private, are often more canny and highly motivated than typical public employees, and are therefore likely to out-negotiate them. Bribing and corruption are not unknown. Large and organized lessees, like our Western cattlemen’s associations, also have long experience bringing pressure through elected officials whom they control through contributions.

The history of public leasing, therefore, is generally one of failing to collect much land rent. Ironically, that rule even holds for the colony of Fairhope, Alabama, founded by idealistic

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Historians will note several exceptions. Distribution of the surplus in 1837, however, was essentially like a surrogate social dividend, on a per capita basis (electoral vote basis, technically). Veteran and school grants showed something of the same animus.

Colin Clark has advanced a system for combining decentralized power with centralized sharing of rents. He would rank local jurisdictions by land value per capita, and then let central government impose a land surtax graduated according to that ranking. This surtax would fall to zero for those with the least land value per capita. See Colin Clark, 1965, "Land Taxation: Lessons from International Experience," in Peter Hall (ed.), *Land Values*, London, Sweet and Maxwell.

followers of Henry George for the express purpose of demonstrating the benefits of socializing land rent. Their cozy heirs and assigns organize to hold rents below market levels, much like any other group of people chosen randomly.

That rule also holds for the colonization of Israel. The Jewish National Fund and the Jewish Agency acquired lands before nationhood. The original purpose of these quasi-public agencies was to lease land to settlers. Unfortunately, they wrote fifty-year leases (the number taken from Leviticus) on fixed terms, so lessees have become *de facto* owners of most of the rent.

Annual revaluation of land for tax purposes might seem to impose extra uncertainty on landowners, in comparison to the lot of lessees on fixed terms. However it is only the amount of the tax that is uncertain; the principle of it is known and certain. Furthermore the principle is such that the tax only rises when exogenous forces raise the earning potential of land; thus the added tax is neither arbitrary nor grievous to bear. When exogenous forces lower earnings, they also lower the tax burden, so that the fisc shares the risk with landowners.

Annual revaluation occasionally will penalize a landowner when the best use of land changes in the midlife of a durable building. Anticipating that hazard, landowners in some times and places will avoid long commitments. This is not such a bad effect, however. Life is uncertain; economic tides are uncertain; optimal land use calls for frequent adjustments to new forces and data. Therefore the most fixed, durable improvement should rarely be encouraged. It is too ponderous and inflexible, too likely to be a monument or white elephant that will obsolesce before it pays off. Some examples are the C&O Canal, the Great Wall of China, the Edsel plant, the Maginot Line, and a dozen buildings we could all pick out in our own cities. In my own neighborhood, near a growing shopping center, over half the parcels have been cleared and rebuilt in the last fifteen years, even without any tax stimulus. In dynamic times and places it is good for builders to anticipate fairly early demolition and renewal, and plan accordingly.

B. Fixed Cash Rent vs. Participation

The traditional Georgist position is that the land tax is ideal in part because it is a fixed cash payment, a function of time and value rather than land use and cash flow. The Georgist model is the American general property tax, where the "taxable event" is not production or use, but simply the passage of time. Georgists would adopt this tax, but modify it by exempting all capital (movable items plus fixed improvements like buildings). Such a tax is like debt service, unaffected by landowner behavior. It exerts maximum incentive leverage, with no disincentive to use or improve land.

"The Lord said to Moses on Mount Sinai … you shall hallow the fiftieth year, and proclaim liberty throughout the land to all its inhabitants; it shall be a jubilee for you, when each of you shall return to his property. … The land shall not be sold forever, for the land is mine; for you are strangers and sojourners with me. And in all the country you possess, you shall grant a redemption of the land." Leviticus 25:1-24. The covenant-breaking for which the later prophets chastised Israel was arguably in the main their failure fully to implement the jubilee concept. Let us hope the Jeremiahs of the 21st century have better news.

Tyler Mall, Riverside, CA.

Sometimes this tax is praised as being "neutral," but it is more than that, much more. By arousing useful enterprise while curbing sheer possessiveness, it affords a unique and wonderful blend of benefits. It drains cash from landowners, and lowers their wealth, thus exerting powerful positive leverage for them to use land fully, to hire workers and produce goods, to create capital, and to manage their lands personally and ably.

At the same time it stops them from hogging lands. It spurs them to disgorge lands they don't need, thus making an active, ongoing market, a pool of available land where all may draw for future expansion if and when they actually do need it. It triggers off a positive feedback loop of better land economy because each speculator releasing land to the common pool helps thaw the whole market. The availability of land for sale lowers everyone's compulsion to withhold land from sale in the fear that there may be no land for sale when needed later. "Just take what you need and leave the rest" is the folk wisdom it imparts in modern, financial terms.

This tax is, arguably, the Western-style feature most lacking in Soviet economies today. There is a Soviet price system of sorts for commodities. Natural resources, however, routinely "are treated as free goods." "The firm does not pay any charges for the resources it holds and uses"; "a firm or association that is divested of assets by its ministry is usually not compensated … and (has) an incentive to misrepresent the value of resources in their current use to prevent transfer." There is, in short, nothing analogous to a land market, and little incentive to economize on land. The need for improved land allocation must be greater than with commodities and equipment, and the scope for new national benefits spectacular. An annual land tax based on the value of land in its best alternative use is a social performance standard of the most objective and compelling kind.

Those are powerful, realistic arguments, and on balance they are probably right. However there is a case, too, for participation. "Participation" means that the landlord (or treasury) shares the costs of land use, and also shares in revenues, usually in the same proportion. Thus the landlord shares in rent, which is the excess of revenues over costs. I here present a case for participation, for the sake of comparison and argument. I also present a few counter-arguments, to clarify my own position.

1. Many private lessees evidently prefer participation to the alternative of paying cash rent (analogous to the property tax on land). This preference is evidenced by the existence of sharecropping (the French *metayage*), royalties, joint ventures, and other such arrangements. The

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Judith Thornton, 1974, "Resources and Property Rights in the Soviet Union," University of Washington, Institute for Economic Research, Discussion Paper No. 74-6, p. 2. Thornton's emphasis here is on exhaustible resources, but the generalization applies to all lands.

Op. cit., p. 6

Op. cit., p. 7.

"Costs" here refers to costs of using and improving land, and *excludes* costs of buying and carrying title to land itself.

significance of private arrangements is that they are chosen voluntarily by (more or less) free agents, who apparently have reasons for preferring participation to fixed cash payments. (On the other hand, these free agents do *not* have the option of anything resembling a property tax, where annual rent is determined by a third party who assesses land price based on market evidence. If private markets offered this choice, lessees might prefer it.)

2. The disincentive effect of sharecropping may be offset in part by limiting the land allowed each cropper, as explained in the seminal works of Professor Steven Cheung. The analogy to taxation implies that a national sales tax, or VAT, should be accompanied by a limit on size of landholding.

3. Lessors may avoid penalizing and discouraging capital improvements by letting lessees deduct their costs from their rental payments in full at the time of negative cash flow. If costs in any year exceed the rental due (as is likely at the time of constructing new buildings), the lessors may let the costs be recouped over time with a specified interest credit. Alternatively, lessors may share costs in the same proportion as they take from the gross revenues.

A treasury, likewise, may let landowners "expense" capital outlays, that is, deduct them from taxable income at the time money is spent on them. This policy has the same effect as exempting from taxation the income added by the new capital outlays. When this is done, the "income" tax becomes purely a tax on land income (land purchase not being deductible at all). If the expenses exceed current taxable income the treasury, like the private landlord, may let the expenses be recouped over time with a specified interest credit. Alternatively the treasury may let taxpayers sell their surplus tax credits to others.

4. In "pioneer" conditions there may not be enough data to appraise land accurately *ex ante*. Then rent collection need perforce be based on *ex post* outcomes. Participation entails sharing information, whereby lessors gain needed data.

"Pioneer" conditions include minerals' exploration in frontier areas, where a great deal of rent is expected in the near future in several Soviet regions. "Pioneer" conditions also include all

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Steven Cheung, 1969, *The Theory of Share Tenancy*, Chicago: University of Chicago Press.

Neither Cheung nor the leading champions of consumer taxes have advocated limitations on landholdings. The absence of this point suggests some lack of balance and consistency in their positions.

Here we meet the basic Averch-Johnson problem, a weakness in this case. Averch and Johnson achieved fame by noting that an economic agent who is guaranteed a fixed rate of return on his or her investments will tend to overinvest, and do everything in an excessively capital-intensive way. For discussion of Averch-Johnson, see any standard text on government regulation of business.

This alternative was adopted briefly in the early 1980s, under the name of "safe harbor leasing," but abandoned when it proved vulnerable to political attack. It was a time when tax rates were also lowered. The policy would be much more acceptable and easy to justify if coupled with a high tax rate and an explicit rationale of taxing land rent.

private land development in regions where commodity, credit, and land markets are underdeveloped.

Conditions of extreme uncertainty are like pioneer conditions, too. The Soviet Union contains vast farm areas where rainfall is highly variable, much like our High Plains region west of the 100th meridian (the proposed "Buffalo Commons"). Where "nature's bounty" is irregularly given and withdrawn, lessors and treasuries charging farmers for use of the bounty should correspondingly raise and lower their claims. To be sure, a property tax based on annual reassessment makes just that adjustment, but historically has tended to lag after the facts. Participation has the advantage of being always and inherently based on current data.

A grave weakness of participation is that it fails to stimulate sales of surplus land. Thus, unlike a fixed charge, it fails to help generate data on land values.

5. Participation creates a kind of community of interest between the parties, who thrive or suffer together. Participation also generates frictions and moral hazards, it is true, but there is also a history of resentment against creditors. Tax collectors who take fixed charges are sometimes subject to the same animus.

The land tax collector is more participative than the lender, however, because "fixed" land taxes can and should be lowered immediately when exogenous conditions worsen (and raised when conditions improve). Sometimes they have been sticky, historically, because levied to support local governments that were themselves heavily in debt. To avoid that outcome, governments taxing land to cover debts should leave themselves some slack, never mortgaging their revenues completely.

6. Participation helps generate information for tax assessments, as taxpayers must disclose information to treasury officials. Unfortunately, however, it only generates data on current realized cash flows, not on values of land titles. That drawback is a severe one. The selling price of land is normally higher than one would infer from capitalizing visible cash flows. Some land is not used at all. Much land is used at far less than its potential. There are invisible kinds of values, whether imputed, potential, ancillary, cash, or expected benefits. Only land sales can disclose those values.

For example, land used for homes and owner recreation yields no cash flow at all, but has high value. With land held for appreciation, again, there is no cash flow to disclose the high values, and the steady accrual of gains in wealth. This quality of "silent accrual" is found in land surrounding cities, or growing retail centers, as well as in land considered potentially mineral-bearing. Forest land yields cash only once in decades, and then in amounts too large to show correct values. Some land is valued mainly for ancillary benefits like the preferential access it gives to adjoining lands for grazing, recreation, water rights, or waste disposal. Other land is valued for expected higher future cash flows in its present use, or some higher use to come. Some land is valued for future "plottage" increments from assembly, or "negative plottage" from subdividing, while yet other land is held for its contingency value, for example, for possible future expansion. Some is held for preemptive reasons, to freeze out competition, and some is used (under current U.S. income tax laws) to yield non-cash tax shelter benefits.

For those various reasons there may be a secondary place for participation in the form of a tax on land income, supplementing but certainly not replacing a tax based on the value of land titles. The great danger of any tax on land income is the ease with which it may change into a tax on labor income. This is the United States' history since 1913. The income tax was originally conceived and sold to voters as a special tax on high property incomes. It has progressively degenerated into being mainly a payroll tax, with many regressive features and special exemptions for property, especially land. To avoid that outcome it would be wise to exclude labor income explicitly in any legislation adopting a participative tax on land rent.

C. A Supplemental Tax on Land Gains?

There would be no land gains if land rent were to be 100% socialized, and if the market expected it to remain so. In practice those circumstances are unlikely, and some would consider them undesirable: the easiest and most accurate way to appraise rent is by monitoring the market in land titles.

When land and/or minerals are "ripening" over an extended period of ownership, a property tax during the ripening period can be shown to collect exactly the proper share of the increment, but only under ideal conditions. First, the market and the foresight of market agents must be so perfect that value rises roughly along a curve of compound interest. Second, tax assessment must follow that perfect market closely.

In practice even rough perfection is, alas, rare. A gains tax is a good way of "mopping up" excess rent that escapes the basic rent tax. It can also be very productive of revenue: in Taiwan the land gains tax raises four times as much as the basic land tax, partly because the gains tax is always based strictly on current sales data. The land tax should be based on current sales data as well, to be sure, but in Taiwan and many other jurisdictions it often is not.

This writer recommends announcing at time of privatization, and regularly thereafter, that landowners should expect a high tax rate, 80% or more, to be imposed on land gains. It should be contrary to public policy for land to attain a value based on expected future resale. Possessory interest with allocation to highest and best current use, and not land speculation, is the desired emphasis.

Instead of being made illegal, resale gains should be closely monitored to audit the system of rent collection. Gains are evidence that basic rent taxes are too low or that market agents expect them either to fall or to fail to keep up with rising rent. A rise in gains is an early warning to view the land tax administration with alarm and move swiftly to correct it. Experience shows that buyers quickly acquire a mental vested interest in collecting rent and avoiding taxes based on what they paid, or others are now paying, for land titles.

Mason Gaffney, September, 1967, "Tax-induced Slow Turnover of Capital," *Western Economic Journal*, pp. 308-23.

W.S. King, "Land Value Taxation in Taiwan: Present Status," Isaac Ofori (ed.), *Real Property and Land as Tax Base for Development*, 1991 (scheduled), Taoyuan, Taiwan, Land Reform Training Institute.

A problem with gains taxes is the "lock-in effect." Holders with surplus land may refuse to sell to avoid tax. A gains tax may be very high, however, without a serious lock-in effect, when coupled with a high ongoing rent tax. The latter compels owners to dispose of surplus lands. Indeed, the "ripening cost" theorists believe it forces premature sales for conversion to new uses. If there is any merit to their rationale we should favor strengthening the lock-in effect. So should they, as a litmus test of their rational consistency and constructive purpose.

The greatest cause of the lock-in effect of the capital gains tax in the United States, however, is not the tax itself but one of its major loopholes: the ability to avoid it via the step-up of basis at time of death. There should of course be no such provision, which is a kind of negative inheritance tax mainly benefitting heirs who have done nothing to deserve it. Legacies, devises, gifts, and other transfers without arm's-length consideration should trigger valuation and tax. So should death itself, when property has to be valued anyway.

Land gain should be defined as the excess of net sales price over depreciated cost basis. An administrative problem to note and solve is the manner of recording capital outlays and their depreciation, in the (presumed) absence of a general income tax.

A supplemental tax on land transfers is desirable as a tool of disclosure. It should be based on gross value of lands transferred (not just gain, and not just equity). Many American states have such taxes, at very low rates, simply to supply data for land assessment. While rates should be nominal, penalties for perjury should be severe: the public has a right to know how much others are getting for its property.

D. Non-standard Resources and Their Rent

For most exhaustible resources, like minerals or over-drafted groundwater, I recommend a combined charge with two components, fixed and variable. The fixed charge should be a property tax based on assessed value of the resource *in situ*. This charge, like the "delay rental" in a standard mineral lease, keeps the lessee from hoarding resources of great potential. It has the same bracing effect as the imperative to service a heavy debt owed to an importunate banker, with sizeable regular payments due and the land subject to seizure. Experience shows that many, probably most, landowners need that stimulus to arouse their productive enterprise and curb their acquisitiveness.

The variable charge should be a tax based on units of production, with deduction of all qualified operating costs, and some capital costs. This charge is modeled on the "net proceeds

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The ripening cost doctrine goes back at least to Richard T. Ely, 1920, "Land Speculation," *Journal of Farm Economics* 2:121-36. It has been rediscovered and recycled many times, for example by Louis Rose, Donald Shoup, and Roger Smith, among others. It is fully incorporated in the recent fad of "rational expectations," which might better be named "rationalized speculations."

Taxing gains at time of death inherently discriminates in favor of deathless corporations, especially those "dynastic" ones that hold but never sell land. A corporate income tax, if there be one, offsets this advantage. Otherwise, periodic valuation of corporate lands, with tax on accrued gains, is necessary.

tax" found in several Western states. Like other "participative" taxes it taps rent *ex post* rather than *ex ante*, generates information, and shares risk. Those benefits come at a price: the variable charge dilutes incentives and creates moral hazards. The case for such participation is now often considered stronger with exhaustible land resources than with standard ones, because of the possible deferral effect. This writer, however, considers that case weak, and recommends, as an eventual goal, raising more taxes from the fixed than the variable charge.

The "eventual goal" cited above requires modifying in the short run. A property tax on the value of mineral reserves only taps rent effectively if levied over many years before the mineral disappears down the track or pipeline. If mines have accumulated high values after long years of silently "ripening" in value, and paid no tax all that time, then a variable charge on severance is needed to capture rent.

The objection will arise that such a dual tax system would tax the same rent twice. Under ideal conditions, however, that is logically impossible: the anticipated severance tax will lower the *in situ* value that serves as the base for the property tax. Double taxation would only occur if owners paid a property tax over many years and *then* were surprised by a newly announced severance tax. In that unusual event, past property taxes might be allowed as credits against the new severance tax.

Minerals' taxation needs special study, and the study needs to have priority: the most aggressive foreign investors penetrating Soviet nations today are oil companies. The companies are veteran, sophisticated, and cunning, with long histories of beguiling unsophisticated landowners at the bargaining table.

Other exotic rent sources have their own technological idiosyncrasies, each requiring distinctive adaptation of basic principles. Some other of these "exotics" are timber, rights-of-way, radio spectrum, aircraft time-slots, fisheries, game, zoning, development rights, the gene pool, utility hookup permits, pollution easements, scenic easements, navigation, surface waters, soils, franchises to use city streets, geothermal wells, and wind power. Each has its own experts, and warrants its own special study.

Robert Paschall, 1978, *Net Proceeds to Mines System of Taxation*, Littleton, CO: American Society of Mining Engineers.

Robert Paschall, 1977, "A Comparison of Minerals' Tax Systems," *Assessors' Journal*.

The exception is where rivals are pumping "fugitive" liquids from common pools. Here, heavy variable charges are needed to counteract what is undeniably excessive motivation to withdraw too much too soon.

Because the principle is clear, developing the precise mathematics would be digressive here.

Irwin Griswold, April 10, 1975, Testimony, Senate Resources Committee, State of Alaska, in *Journal Supplement*, April 15, 1975. Griswold was Dean, Harvard Law School, 1946-67, and solicitor general of the United States, 1967-73.

IV. Modifying the Credit System

A. Banking without Land as Collateral

Credit follows collateral. In periods of high and rising land prices, borrowers get used to pledging land to secure loans, and lenders get used to demanding it. Socializing land rent, as proposed herein, lowers or eliminates the value of land as loan collateral.

On the good side, this lack of land collateral would stop lenders' discriminating in favor of landowners, as they do now. It would remove a major cause of the concentration of economic power and control, that is, the clustering of credit around original nuclei of large, superior landholdings. The credit is often used to buy still more land, to reserve for possible future use and at the same time to withhold from competitors. Such concentration and market control form the ugly side of extant Western "capitalism," when enterprise degenerates into greed and acquisitions supplant innovations.

As Rainer Schickele wrote, "the basis of credit is not marginal productivity but collateral security." He meant that lenders are concerned not with the productive use of their loans, but with the security provided by borrowers' ownership of old wealth.

As Keynes put it in his *General Theory*, there are two kinds of risks: investment risk proper, and lender's risk. "Investment risk" depends on the productivity of new capital; "lenders' risk" depends on borrowers' old collateral, like land. The social purpose of investing is to create capital; the individual purpose is to buy income with security. The second purpose leads lenders to lend to the rich in preference to the productive. The principles are at odds; the productivity principle is clearly better from the viewpoint of basic micro efficiency.

The marginal productivity basis of lending is also better in terms of macro stability. Flows of credit dominated by cycles in the land market are highly unstable. The current S&L calamity in the United States exemplifies and should settle the point. It has many precedents, going back at least to the Dutch tulip bubble of 1634 and the French-English Mississippi and South Sea bubbles of 1720. The rule has been that following each collapse the hung-over lenders woke up penitent. Reacting to the excesses, they adopted something like the English Banking School philosophy of avoiding real estate loans and sticking with self-liquidating commercial loans, only to fall off the wagon in the next land boom, repeating the cycle. How easily one generation forgets the hard lessons life taught the one before. "When will they ever learn?"

Rainer Schickele, 1942, "Obstacles to Agricultural Production Expansion," *Journal of Farm Economics* 24:447-62. *In bello veritas*.

It would help if historians recorded the details more scrupulously and reminded the world more cogently. University of Chicago banking historians Lloyd Mints, Milton Friedman, and Anna Schwartz have done much to belittle and bury the matter completely; this result is a tribute to their influence, but not their sagacity. Friedman's and Schwartz's history of banking came at the right time to fulfill the wishful thinking of a generation wanting to be free of the fear that something other than human error by a few directors of the Federal Reserve Board brought on the Great Depression.

In the absence of land booms, however, bankers would have to stay on the wagon. On the bad side, low land prices raise new problems of how to transfer funds to builders. If the free market is to provide ample flows of investment, the credit system must adjust to life without land values. Actually, however, it has often done so anyway, following the periodic collapses of land markets such as those already cited, plus those of 1798, 1819, 1837, 1857, 1873, 1893, and 1929, to mention only the extreme cases. In those periods of atonement, credit systems worked quite well without depending on real estate as collateral. We would be much better off to keep them working that way permanently.

Many particular lenders practice the arts of lending without land collateral. Factoring inventories is a thriving business. Building on leased land is commonplace, with both private lessors like the Wrigley Company of Catalina Island and the Irvine Company of Orange County, California; and public lessors like the Crown Provincial of British Columbia, the county of Los Angeles, the Port of San Francisco, the state of Alaska, and countless others. Chattel mortgages are common, secured by movable capital. Even construction loans are secured mainly by capital, not land, because new buildings normally outvalue their sites, even on dear land and more so on cheap land. Some developers borrow on the security of signed leases.

As credit follows collateral, so it flees taxes. The policy proposed here is not just to tax land, but to untax capital, and untax profits drawn from skill in management, and untax wages and salaries generally. That which is less taxed becomes more creditworthy. The flow of credit will turn away from those with accumulated wealth and monopoly towards those with skill and daring to use it better. The result is to make capitalism work as advertised, not in the decadent way as charged.

B. The Hazards of Public Credit

When we socialize rent its value as collateral is not lost, it is transferred to government. A nation with a sound tax system becomes the most creditworthy borrower. Add a central bank and the public credit is sound—possibly too sound.

In the best scenario an enlightened, enterprising, progressive leadership raises capital to provide needed public works, guided by economists steeped in modern cost/benefit analysis, well-salted with common sense and local geography. Cynics may deride that as a fairy tale, and

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Wrigley owns the city of Avalon, streets and all.

Irvine owns much of Newport Beach, the Fashion Island shopping mall, and the city of Irvine, as well as about 70,000 additional acres.

The provincial government owns 95% of the area of this vast province.

Marina del Rey is a prize holding.

Pier 39, the Cannery, and Ghirardelli Square are among its holdings.

Alaska owns land adjoining Prudhoe Bay, under which the oil-bearing Sadlerochit Formation lies.

cite instances of waste, vanity, and corruption; but for all of that, trillions of dollars' worth of essential public infrastructure in place and working do attest to the real existence of some effective public leadership. It is what has made civilized life possible.

In the worst scenario, however, a corrupt, stupid, spendthrift administration borrows heavily, connives to pay excessive rates, takes its graft, mortgages public revenues, and wastes the proceeds. Subsequently government becomes an oppressive tool of creditors charging usurious rates to extract rent from citizen-taxpayers, to enrich lenders many or most of whom may be aliens. Then taxation becomes totally "onerous" in Alfred Marshall's sense, and in the ordinary meaning as well. Clearly it is not enough merely to have a good tax system.

A nation embarking on capitalism needs some precautions to forfend this perverse outcome. We cannot plead innocence: history gives ample warning.

1. No debt should be incurred without public vote, unless such debt is explicitly *not* secured by land tax revenues.

2. There should be a constitutional debt limit fixed at less than half the capitalized value of "free revenues" from land rent. "Free revenues" should be defined as the excess above entitlement payments (social dividends and their surrogates). By this device, social dividends are given the status of "birthrights": they take priority over debt service and may never be alienated by the government.

The rate of capitalization ("cap rate") should be no lower than the interest rate on long-term government bonds. By this device, if the government's credit rating slips, its debt limit falls automatically, getting attention and demanding correction.

3. Any "emergency" debt in excess of the limit should be subject to constitutionally mandated taxation, the proceeds of which should be earmarked to increase the social dividend. Granted, this "tax" will be passed right back to the borrower in the form of higher rates; but those higher rates will be the onus of the bureaucracy, while the tax revenues will pass, in the American expression, "outside the Beltway."

It will be pointed out that no such scheme is foolproof because "money is fungible." I take the point. The idea is simply to make tampering difficult and visible; nothing can make it impossible. No system is secure against public indifference. There is no indifference to entitlements, however.

The model fits many third-world nations.

There is more support for some entitlements than others. Time was when our ethic demanded charity and justice for "helpless widows and orphans," but the widows today are organized, and the orphans impoverished and neglected. The justice they receive is of the criminal variety. As accused criminals, ironically, they enjoy more constitutional rights than as pathetic waifs. A nation that values its future requires an appropriate "extended family" ethic to

The central idea is that government become and remain an agency to pool rents and then channel them faithfully into public goods and services, social dividends, and capital formation. "Whenever any form of government becomes destructive of these ends, it is the right of the people to alter or to abolish it." There is no other ultimate safeguard.

V. Starting up the Market

Soviet land is mostly already tenured, held by various state agencies. Starting up a system of property will not be primarily a matter of surveying and settling wild lands. Still, shifting to a market economy will entail massive changes in land use and infrastructure, and therefore in platting and subdividing land, and transferring and recording titles.

The last, if done correctly, is a ministerial technicality. If done incorrectly, slowly, or with bureaucratic nightmares of inertia and delay, recording can become a major obstacle to progress, as in Peru. An administration that cannot overcome such a totally unnecessary barrier will never accomplish much. Without belittling the matter, we here assume it will be handled well, and move on.

The first priority in making a market is pressing state agencies with surplus lands to disgorge them. The most administrable, humane, non-catastrophic kind of pressure is an annual tax based on the value of land. This tax should be levied on state as well as private landowners.

It will be objected, there is no point in the government taxing itself; it just stirs money around the same pot. That dissent misapprehends the motives of bureaucrats, the difficulties in monitoring their performance, their peculiar motives for hoarding land, and the limitations of budgeting. Once a state agency acquires land its social cost never again appears in the budget, because budgets are in cash, and the land is neither mortgaged nor taxed. Taxing the land in proportion to its value imposes a visible, explicit social audit on the bureaucrats in charge: they must budget the tax money annually. Anyone with time on the cross of bureaucracy, public or private, can fill in the rest of the story.

Determining value in the absence of pre-existing markets is pioneering; at the start some trial-and-error groping is to be expected. It is a problem: let us not fret vainly over the unavoidable, but solve it. Using the method of taxation, with annual revision of assessments, limits all errors to one year at a time. Assessed values for taxation should be adjusted frequently at all times, and more so under pioneer conditions. That approach is quite an improvement over the alternative of collecting all the value in a single sale up front. Under the up-front method, one error is forever, and the error is made at time zero when data and experience are minimal.

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declare and uphold the *economic* rights of the helpless spawn of the poor and negligent.

Every American schoolchild learns this familiar passage from the U.S. Declaration of Independence, 1776.

Hernando de Soto, Summer 1990, "The Creation of Property Rights in Peru," Urbana, Illinois, the *ORER Letter*.

James F. Smith, April 21, 1990, "Land Called Key to Legal Crops in Peru," *Los Angeles Times*, p. A3.

An excellent method of getting markets started is this: require each state agency to designate, say, 5% or more of its land for sale, and set an asking price. The asking price should be the taxable value of the land until it sells. The asking price should also be the basis for valuing the agency's other lands, taking account of differences in quality.

The method is not without flaw: agencies may possibly select their worst lands to sell, and assessors will lack confidence in their ability to quantify differences in quality. Administrators should anticipate those problems, however, and counter by importing some experienced assessors to help "seed" the system. Neophytes in this field have no idea how widely values range, and the degree to which location dominates other influences on value.

Taxing land, and increasing sales to generate assessment data, are mutually supportive. Get the market started and each boosts the other in a benign "positive feedback loop." Taxing land motivates sellers and raises sales; sales provide data to improve and justify tax assessments.

Conversely, resource markets without motivated sellers are unworkable, and generate little data to help assess land correctly, as exemplified in many third-world nations. Indeed, that is a factor keeping them in the Third World. Closer to home, however, in California, water-use licenses also exemplify the point. These licenses are (with rare exceptions) exempt from the property tax. In an arid region, densely populated, they are of the highest value. Over more than a century hardly any major transfers have occurred. Until recently this viscosity could be attributed to various institutional obstacles to sales, but five years ago those were mostly swept away. The Legislature recognized the urgent need for transfers, accumulated over 150 years or so of rigidity, and paved the way, so it thought, for a new era of water marketing.

The result, however, has been nil. Water is still not being transferred, even though its productivity may vary by factors of ten or more within a few feet across ancient boundaries. Surpluses create swamps across the street from deserts, yet buyers and sellers are not coming together. The reason, simply put, is unmotivated sellers. Those with ancient licenses pay nothing to hold them, but look forward cozily to higher offers in the future. By not selling we (I happen to be one) generate no data on which the value of rights might be assessed. This is the kind of logjam that must be broken to get a land market working.

I have noted earlier there are cases for tapping rent through a fixed charge, and through "participation." To unclog a log-jammed market like that in California water-use licenses, the case for a fixed charge is overwhelming. Here is a notoriously commercial, mobile society, where almost everything is for sale, and ordinary real estate turns over at a good clip. In its midst is one critical resource, water, that never turns over in spite of crying needs. Why the difference? Water licenses are exempt from the property tax; sellers are unmotivated.

Transferring land to private tenure involves several steps:

a. Platting and surveying

Units should be small, to accommodate individual bidders. Buyers may amass and consolidate small units if they wish; offering small units simply gives small buyers an equal chance at the

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These licenses are colloquially called water "rights," but the usage seems improper. A "right" is possessed by everyone, and these licenses certainly are not.

start, cutting out speculative middlemen and providing flexibility.

b. Subdividing

Subdividing land is a key event that controls the layout and timing of most infrastructure, takes capital, allocates land to r.o.w., and permanently stamps settlement patterns. Interactive decision-making is required between (mostly) private on-site and (mostly) public "inter-site" sectors. "Inter-site" means on the public r.o.w. among the parcels, while "interactive" implies mutual learning and accommodation in a swiftly changing scene. Land taxation gives the public sector a powerful tool to assure early economic response to public initiatives, for example, the development of private sites accessed by a new transit line or water system.

Land taxation does not guarantee that only wise public initiatives will prevail, but it gives public planners an objective guide for laying out routes and sizing and timing improvements thereon. They should place improvements where they will generate the most new rent from the served lands, and locate nothing where it will not thus pay for itself. The familiar marginal rules of economics should apply to increments, with planners bearing in mind that the public works in question are mostly decreasing-cost facilities where the payoff is in higher rent rather than variable user charges.

c. Sizing parcels

Parcels should be sized to maximize unit value (per square foot, square meter, or whatever small unit be used). Unit value should be maximized after deducting costs of allocating land to r.o.w.; improving it; and operating, maintaining, and replacing the improvements over time. Such land planning is a developed art, available for import.

Privatizing land implies drastically revising infrastructure to accommodate new patterns of use. In rural areas it calls for supplying publicly the farm roads and utility lines now supplied internally by collectives. This revision will absorb a large share of national effort and capital for years to come. It will also keep alive part of the public sector: free market capitalism never has operated without help from a large public and publicly regulated sector.

Successful capitalism depends on fostering its least conspicuous, most belittled members, the small, independent firms, from the mom-and-pop operations on up. These can only thrive when functions of huge optimal scale, like supplying water and power, are separated from basic on-site land uses, and provided impartially to all. Small parcels of land must have access to transport and utilities on the same terms as large ones, without discrimination. In this way, and with a fluid land market, the optimal size of parcel will turn out to be much smaller than conventional

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The theme is developed in Mason Gaffney, May 1969, "Land Planning and the Property Tax," *Journal of the American Institute of Planners*, pp.178-83.

Unfortunately, the more successful practitioners are even more skilled in influencing city councils than in practicing their engineering/economic arts, and need to be watched.

wisdom today imagines.

Early infrastructure initiatives should be low-cost and as flexible as possible, with no thought of building for the ages. Private entrepreneurs often behave in ways planners never expect, the more so if the planners lack prior experience in the private sector. There is no surplus capital to waste on durable facilities people will not use fully over their planned lives. Experience and mutual understanding must be gained before anyone dreams of stamping eternal patterns on land use.

Interactive development planning is a messy, ongoing process one must experience to understand. The somewhat anarchic American process may be too alien to Soviet cultural patterns to import whole. Japanese success importing Western ideas comes to mind: they did not just import, they Japanized. Each nation will be great in its own way. It would be surprising if Soviet nations did not improve on imported American models.

d. Recording titles and deeds

All deeds and all consideration upon sale should be public information, and publicized proactively. Summary information, standardized to a unit-area basis, should be mapped, in a form easily understood by normal literate persons. The maps should be posted and/or distributed. A Bureau of Land Statistics should be formed and funded to monitor, analyze, and publish these data regularly.

Payments should be made only in cash, through a public (or audited private) escrow. Penalty for violation should be severe and mandatory. No unrecorded contract should be enforceable. This is the occasion to record public servitudes, announcing and repeating the public claim on ground rent.

All debts secured by capital affixed to land should be recorded, and be unenforceable otherwise. Every recording should explicitly state that the private debt is subordinate to the public right to ground rent. Land itself should not be pledged by private parties.

VI. Summary and Conclusion

Privatizing property and freeing markets in Soviet nations should not be imitative but integrative, synthesizing a new economy from the best of capitalism and socialism. The

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Mason Gaffney, April 1969, "Economic Aspects of Water Resource Policy," the *American Journal of Economics and Sociology* 28(2):131-44. This article describes how small farmers in the western United States pooled their economic strength to form "irrigation districts," local municipal-type organizations charged with developing, storing, and distributing water to small farms. Districts have the power to tax land (exempting capital); to borrow money; and to force inclusion of holdout landowners. The result was rapid subdivision and compact settlement. The existence of many small farms, compactly grouped, in turn fostered cheap distribution of other utility services, and the development of "total community." In some zones of intensive citriculture, viable farm units at times became as small as an average of only ten (10) acres, incredibly low as that seems. These were times of intense economic pressure, when the fixed land tax rose to extremely high levels.

centerpiece of policy proposed here is social collection of land rent to finance government. Selling land quickly without reserving tax power is rejected as being financially disastrous and politically abject and submissive to alien buyers. The policy of taxing land in perpetuity is shown to make land markets work better.

The ethical reason for taxing land rent on an ongoing basis is the confident expectation of the unexpected, sure to cause future windfalls and wipeouts. In addition someone must pay for future infrastructure, which raises rent on the lands served. The political reason for taxing and distributing land rent is to unify the nation by giving economic substance to citizenship.

Leasing and taxation are compared, and taxation chosen as the superior way to socialize land rent. Annual revaluation for tax purposes is the key difference.

Fixed assessment is contrasted with participatory taxation of rent. The verdict is mixed, but on balance fixed assessment seems more practical, and socially beneficial. Schemes to offset the diluted incentives and moral hazards inherent in participation are too byzantine to command our conviction. Fixed cash payments based on assessed land values have the advantage of stirring up the land market, which otherwise tends toward monopoly and torpidity. A supplemental tax on land gains is recommended to "mop up" excess rent that escapes the basic annual tax based on assessed value.

Non-standard resources require attention by specialists to adapt basic tax principles to their idiosyncrasies. For exhaustible resources there should be a combined charge with two elements, fixed and variable.

Banking must be modified to extend loans without using land value as collateral. Ample precedents and experience are available for lending on other bases. The favorable result will be channeling funds more on the basis of productivity, and less on the basis of collateral than is the current practice. The macroeconomic flow of funds will become much more stable, with no more S&L scandals.

Public credit must be safeguarded to be sure tax revenues are spent for the benefit of citizens and the local economy, instead of for foreign creditors. It is suggested that a substantial revenue be earmarked for social dividends, and given constitutional priority over debt service. Let debt service always be strictly subordinated to citizens' rights.

To start up the market, moving holdouts is the key, turning them into motivated sellers. The case is overwhelming for imposing a fixed annual charge based on value. Lands held by state enterprises and agencies should be assessed and taxed. Agencies should be required to prime the market by offering a portion of their lands for sale, and be assessed on the asking price. There is a positive feedback loop between sales and assessments used for setting land taxes; one good crank starts the motor.

Attention is needed to techniques and principles of dividing land into small parcels and serving them with utilities. Platting and surveying, subdividing and sizing parcels are more than specialized land-use decisions: they determine the viability of a market economy by fostering small, independent firms on which competition and dynamism depend.

Recording deeds and titles should be more than perfunctory and ministerial. Data thus gathered should be analyzed and published to keep the public aware of and participative in the system.

Advice is easier to give than take. We sympathize with our Soviet colleagues in their travails, we envy them the adventure of building a new society or societies, and we admire their courage. We wish them shining success to inspire us and every nation, as we hope our achievements may inspire them. "As one small candle may light a thousand, so the light here kindled hath shone to many." -- William Bradford, *Of Plimoth Plantation*, 1648.