The Physiocratic Concept of ATCOR (All Taxes Come Out of Rent)

Excerpt from notes on "Adequacy of Land as a Tax Base"

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3. Raising taxable rents by untaxing capital and labor, production and exchange: the concept of ATCOR (All Taxes Come Out of Rents)

The meaning and relevance of ATCOR is that when we lower other taxes, the revenue base is not lost, but shifted to land rents and values, which can then yield more taxes. This is most obvious with taxes on buildings. When we exempt buildings, and raise tax rates on the land under them, we are still taxing the same real estate; we are just taxing it in a different way. We will show that this "different way" actually raises the revenue capacity of real estate by a large factor. There is much recent historical experience with exempting buildings from the property tax, in whole or part. It has shown that builders offer more for land, and sellers demand more, when the new buildings are to be untaxed. **The effect on revenue is the same as taxing prospective new buildings before they are even built, even though the new buildings are not to be taxed at all.**

Land value is what the bare land would sell for. It is specifically and immediately most sensitive to taxes on new buildings, and on land sales, as well as to new and more stringent building code requirements or zoning that often discriminate against new buildings. Lowering the income tax rate on capital gains has doubtless contributed to the following run-up in land prices.

Where new buildings are "coded" more severely than old, it enhances the value of the old land/building packages. This premium should be considered part of land value, and taxable as such.

Examples of ATCOR

A. Historical experiences with exempting buildings leading to land booms.

NYC, Western Canada, Hong Kong, Taiwan, Australia, South Africa, San Francisco after the fire, Chicago after the fire, California Irrigation Districts, Cleveland 1903-1920, Toledo, Detroit, Portland, Seattle, Houston, San Diego.

Re Australia, Hutch 1963 pp. 14-15. Divides Australia into UCV states (Queensland, New South Wales, Western Australia) and improvement-value rating states (NAV) (South Australia, Victoria, Tasmania). Table p. 14 shows value of improvements. cf. with ULV as 100, for town, country, and whole state 1939/1940. UCV states are much higher. This is not because of lower LV: **p. 16 table shows UCV per land taxpayer was nearly the same in both groups, ca. £11k per land taxpayer. (**Data base: 23rd Report, Commissioner of Taxation dealing with the Commonwealth Land Tax. Data cannot be extended because the Commonwealth retired from taxing land from July, 1952.)

B. Familiar micro cases

Lowering corporate income tax raises stock markets.

Commercial rents, multipartite, lower share of gross revenues is traded off for higher fixed rent. Examples from retailing; oil leases; Port of Milwaukee leases; farm rents; Cheung studies; etc.

Payroll taxes and disincentive kinds of business taxes make firms leave California, currently, lowering demand for land. (Walter Rybeck has sagely suggested that we distinguish two functions of “business”: wealth-creating and resource-holding. A good tax system will not make people pay for creating wealth but for simply holding resources.)

C. The Peace Dividend Effect. World history of peace dividends ff. by land booms.

D. The Resource Curse Effect: an influx of mineral revenues, obviating other taxes, leads to land booms.

E. Historical experience with an income tax exempting wages: the United States, 1916-1940. “Pay-as-you-go” war finance in the United States during WW I.

F. Utility-rate effect. Lower rates mean higher land values. Hotelling, Vickrey.

The Logic of ATCOR

A. Land supply fixed, capital and labor elastic, demand elastic.

The thesis that all taxes are shifted to landowners follows logically from two premises. One, after-tax interest rates are determined by world markets, so the local supply of capital is perfectly elastic at a fixed, after-tax rate. Two, labor has been reduced to so low a level that it cannot bear any more tax burden. Anyone may test the premises by observation.

Elastic labor supply, as assumed by Keynes, re effect of demand on employment. The supply of "work" (as opposed to "labor," defined as so many warm bodies) is highly elastic so long as there are unemployed. When we find work for the unemployed and underemployed, labor gains without its costing land or capital anything at all. In fact, it is even better: labor gains while benefiting other taxpayers, because of lower dole costs, lower crime costs, etc. The enhanced psychic benefit of universal job security is also worth a lot, although not in direct money. In the era when Keynesianism was in flower, many alleged that the social cost of putting the unemployed to work is zero.

Nowadays, of course, Keynes is out of style with the dominant anti-labor schools. Unemployment is simply leisure, a voluntary choice, a matter of personal taste. And yet, Chicagoans like Gary Becker freely postulate elastic labor supplies when they blame unemployment, as Becker routinely does, on minimum wage laws. "It's simple: hike the min wage, and you put people out of work" –Gary Becker, *Business Week*, 6 March 95.1 It's not clear if Becker sees the parallel, but that is a Keynesian assumption.

It is likely that real wage rates would rise, as better land use increased demand for labor and lowered product prices. This was the theme of *Progress & Poverty* (*P&P)* (George, 1879), and the primary goal of his reforms. However, that was before we had heavy payroll and income taxes on labor. Now, it is entirely possible for the abolition of such taxes to let after-tax wage rates rise while before-tax wage rates remain the same, or fall. There is ample "room" in the present tax system for that to be a likely outcome. In the event, however, that real wage rates should rise enough to absorb some of the gains from tax reform, few would call it a calamity.

Also, the rise of wages in the Georgist system implies a rise of GDP. The rise would result from removing the excess burdens of current taxes, which in turn will first raise the marginal productivity of labor. That would ensue from opening what the English Radical Liberals (who ruled England in Edwardian days) called the "internal frontier." One can also view that as ending the artificial scarcity of land, an approach I use later in this work. This means that workers who now each add, say, £10,000 a year to GDP in menial tasks, or struggling on marginal land, would instead add £20,000 a year each. While this would redistribute income against rents, much of the increase would come from a net rise of GDP.

The net rise of GDP will raise the demand for land for residential and recreational (R&R) uses, because land is a superior good. (Cite *P&P*, and data herein on the point.) Lowering after-tax rents will, of itself alone, lower the R&R demand for land, but raising other factor shares, including rates of return on real investing, will replace the lost demand from any given GDP. The rise of GDP will more than replace it.

Elastic capital supply, observed and therefore assumed by most economists. Mostly they emphasize world markets, rapid transfers, arbitrage. In addition, even in small closed economies, there is underemployed capital, just like labor. This is because the return is held down by taxation. So it goes into untaxed consumer goods, and tax-exempt forms of capital like housing, eleemosynaries, foundations, government works, personal property, etc. From this would spring a large supply, when all uses of capital are untaxed. Here is the elasticity in supply of capital. George recognized this, although he had his own way of expressing it. He did not regard consumer capital as being "really" capital, but he did observe people living on it while they produced other capital. During WW II we experienced a graphic example of how people can draw down consumer capital to meet an emergency need.

An important and influential exception was E.R.A. Seligman, who expressed his point memorably: "There is no fund of capital floating in the air to be brought to earth by the magic touch of Mr. H.G." Parallel ideas are found in Harriss, Harberger, et al., q.v. below. On the left wing, critics of tax breaks for investing commonly belittle and dismiss the breaks by alleging they only advance a fixed lump of investing, rather than adding to the sum over time. I will show, rather, that the "lump" is full of yeast and can grow: a) by capital formation, b) by better allocation of capital, c) by import of capital, and d) by faster turnover of capital.

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1 David Card and Alan B. Krueger say otherwise. Becker cites studies saying it is so, by Donald Deere and Finis Welch, Texas A&M; Kevin Murphy, U. of Chicago. Papers at Jan AEA mtgs.

Land value based on opportunity cost of land in highest and best future use. Calls for drastic reassessment of land when buildings are exempted, because that means FUTURE buildings are to be exempted. The effect on revenues is like taxing future buildings before they are actually built, even though they are not to be taxed at all. Logic validated by experience in growing boroughs of NYC, 1922-1933.

Compact settlement would create new rents via the synergies that are now aborted by scatter.

B. Venerable tradition of ATCOR in the history of economic thought:

- Physiocrats, preceded by Locke and Vanderlint

- Adam Smith on "indolence of landowners"

- Paul Douglas; Bronson Cowan; Ebenezer Howard; David Bradford, et al., 1992 NTJ; Dick Netzer (with caveats);

- Others?

C. Muddying the waters of theory.

Forward shifting of property tax, a la Musgrave. This shift requires our assuming the tax is imposed on just one land use, usually housing, in one small jurisdiction. It is what Howard Jarvis seized on and used to promise tenants that lowering property taxes would automatically lower their rents, since property owners, as he put it, do "not pay one cent" in property taxes, but shift them all to tenants. As soon as Prop. 13 passed, rents shot upwards, and have never looked back except in particular micro-markets like cyclical Silicon Valley.

This is one result of displacing production theory by price theory in economic doctrines. In production theory you would assume elastic demand, and focus on the effect on factor proportions (changing productive processes and products, a la Kneese and Bowers).

- Fixed capital supply. Harberger; Seligman; Harriss

- Twisting the Ramsey Rule by most economists. McLure and Zodrow; Lindsey, and most texts on public finance as examples. Notable exceptions are Ramsey himself, Pigou who inspired him, and Stiglitz.

D. Summary on ATCOR.

The revenue capacity of land, when it is substituted for other tax bases, is comparable to current revenues. Owing to efficiency effects, and renewal effects, it may well be higher. The major reservation is that the supply of labor is not totally elastic, so some of the revenue gains may be "lost" in higher wage rates, but on the whole higher wage rates are socially desirable, and serve to lower many public costs as for welfare, policing and jailing, aggressive military spending, make-work projects, etc.