# Why Should We Care About Land Value, and Why Now?

Mason Gaffney, Working Paper, September 2005

## A. A land-boom is a zero-sum prosperity.

With the fall of Soviet communism the United States prepared to enjoy a peace dividend of lower taxes. Modern technology would raise productivity and supply streams of wonders and diversions. Many indeed did prosper as the stock market, in spite of ups and downs, broke through old ceilings. Rents on most income properties rose steadily. Old homes, once cheaply bought, soared to values beyond the dreams of avarice. Cow pastures and ranches and woodlots became shopping centers, turning their owners into magnates. Deposits of oil and gas, yesterday submarginal, became bonanzas as costs fell and prices rose.

However, the prosperity of high rents and land values is not a rising tide that lifts all boats. Rather, "It is as though an immense wedge were being forced, not underneath society, but through society. Those who are above the point of separation are elevated, but those who are below are crushed down" (George, 1879, p. 9). Zero-sum prosperity does not merely fail to relieve poverty, it actually produces it. It is the same land, only higher priced. The quantity of land is fixed. The homeless, evictees, the young, and the "cradle-poor" (those who inherit nothing) are only the most conspicuous have-nots. The flip side of soaring land prices is that land scarcity is squeezing *all* jobseekers, homeseekers, and would-be entrepreneurs. The price of shelter has risen to make it the major element in the cost of living—well over half for some people in some regions. If we count commuting costs as part of shelter costs, those who secure cheaper housing at the cost of longer commutes are still spending high fractions of their income on shelter.

Many have-nots are suffering new travails. Real wages of blue-collar labor peaked about 1976 and have dropped 10% to 15% since then, and probably more if the true cost of buying a house and lot were properly included in the CPI, and the cost of commuting were properly deducted from net wages. The labor-price of a farm has risen from about six years' wage income to about twenty, more than a family can save in a lifetime (Gaffney, 199x). While commuting consumes fathers' spare time, mothers have joined the workforce to maintain family income, so both are neglecting their parental and community roles, rending the social fabric and loading legions of neglected children onto the schools, social agencies, courts, and jails. Unemployment is up. Layoffs haunt most workers, even the highly paid; those laid off have big trouble finding new jobs. Beggars who "will work for food" stand or sit or lie where busy feet once strode. Public parks, in cities where condos sell for multimillions, serve as bedrooms and bathrooms. Social services, once a vital safety net, are shriveling for lack of funding. The number of those that the census counts as "in poverty" keeps rising. The "poverty line" is arbitrary and arguable, but it is clear that more and more people are falling below that arbitrary line.

Wealth and income are distributed less and less equally, by every standard measure. Mere data glance off the firewalls that shelter many hard hearts from empathy, but the fact fosters social upheavals like the riots of big Los Angeles and little Benton Harbor. Both of these occurred soon after major tax "reforms" had shifted taxes off property and onto taxable payrolls, commerce, and the consumer needs of the poor. These tax changes breached the previous social compact. They helped create a society that, as Matthew Arnold put it, "materializes our upper class, vulgarizes our middle class, and brutalizes our lower class." It should not surprise anyone if a brutalized lower class occasionally riots.

The tax reforms of Proposition 13 and its clones reflect a mindset where democracy with majority rule, the panacea we sell abroad, is a menace at home. Jon Coupal, president of the Howard Jarvis Taxpayers' Association, explains. "If you lower the 2/3 vote requirement [of Proposition 13, 1978, and Proposition 218, 1996] you are essentially allowing those who don't own property to levy taxes on those who do." It would be a "disaster" for property owners. Coupal and the Jarvis group favor local government by special districts in which only landowners can vote and hold office, and the rule is one acre, one vote, rather than one person, one vote. Such districts can be, and some are, ruled by just one person or corporation, while enjoying all the status and privileges of municipalities (Goodall, Sullivan and Goodall, Morales, Sheehan, et al.)

B. Modern redistributive taxation is not redressing the balance, and has turned counterproductive. For years a majority lived in the faith that modern taxation would solve those problems by redistributing wealth, or at least income. Professors preached it to students, most of whom lapped it up. That faith has waned, to be replaced by a new understanding, or at least another faith, that most modern taxes impose serious collateral damage or "excess burdens," meaning they drag on and distort economic incentives, so they cost taxpayers and the economy more (the "excess burden") than they raise in revenue. The idea is old, but its ascendancy is new. From about 1940 to 1980, dominant academics downplayed excess burdens, especially from taxes proportional to income. Furthermore, they said, local tax burdens rank low among reasons for locating industries here rather than there. Those were the correct views, for years. They still live among a large minority, but most people, and certainly those in power, are now sensitized to the great collateral damage of excess burdens.

[[Jan 17-23, NYC lifts sales tax on shoes and clothes costing <$500@. Sales rose by 77%, says Chas. Millard, Pres., NYC Ec Dev Corp. Cit IT, 3/98 p4. WSJ 1/28/98 A1

More generally, discount sales routinely raise demand, basic fact of merchandising. Only w.r.t. taxes do some ecsts refute it - presumably out of sympathy with taxing bodies.

Need for devices like OECD, and Bradley-Burns, and interstate compacts vs. internet, show wide recognition of the elasticity.]]

Indeed, Ballard, Shoven, and Whalley claim that the excess burdens of the U.S. tax system in 1973 ranged from 17% to 57% of revenue (McLure and Z., 182-83). I do not vouch for their methods or conclusions, or even their lack of prejudice, but their claim does show whence bloweth the wind these days.

C. The excess burden of modern taxation worsens land scarcity. The truest and most sensitive gauge of excess burden is not the “Harberger triangle” of Chicago theory, which trivializes excess burden. Rather, it is how the market misallocates land. The market is driven awry by distortive taxes on using (as opposed to holding) land, to the point of misuse, underuse, and non-use of land. This aggravates the natural scarcity of land, creating an illusion of greater scarcity than we can blame on either nature or human fecundity (although many do so). Distortive taxes, in concert with other social biases, create an artificial scarcity of land.

D. Artificial land scarcity leads to urban sprawl, and other forms of territorial expansion and scattered settlement—in farming, water supply, forestry, mining, and other industries (Gaffney, 19xx). Sprawl and territorial expansion do help to relieve land scarcity, but only at frightfully high cost. They waste land, energy, air quality, commuter time, social and economic synergies, tax money, and capital in extended infrastructure. They invade habitat and wildlands and have provoked the environmental and green movements on the left, and NIMBY and nativist and Malthusian and privatization movements on the right, into hypersensitivity over land scarcity. These activists will no longer let economists ignore the issue.

E. Public debts are rising dangerously. As tax revenues fail, public debts cumulate inexorably. Howard Jarvis, promoting his Proposition 13 in 1978, won support by excoriating “obscene surpluses” in the state treasury. Where now are the obscenities of yesteryear? A high and growing fraction of public revenues are spent on interest, and credit ratings of public bodies are falling, a vicious circle pointing toward disaster if the vicious circle (a positive feedback loop) should spin out of control. The concept of the vicious circle is uncomfortably at odds with the resurgent faith that markets are always equilibrating and stabilizing, but when firms or states or nations court bankruptcy, the old bogey rises again. Wall Street ideologues on weekends may preach lower taxes, but on weekdays Wall Street bankers shun states with weak tax bases.

U.S. debt is called “non-defaultable” because the Fed can always monetize it in a pinch. It is a snug thought, but too smug, because foreign lenders do not always feel that way. They could incite a run on the dollar, as other lenders have done on the pound and the baht. This kind of vicious circle, the currency run, is alive and virulent, and a very present sanction against inflation. The dollar, as the international standard currency held by every nation, is vulnerable, especially with the United States having become the world’s debtor as well. So as we cut taxes, there is need for backup and replacement revenues at every level of government, even the federal.

F. National capital is draining away. Most economists today see a need for more net domestic capital formation, as the United States is on its way to becoming a debtor nation, running large trade deficits every year. Public debts themselves are a major leakage of saving. In the neocon paradigm these public debts are no problem because they stimulate equivalent private saving—the “Ricardian Equivalence Theorem.” Their reasoning is forced at best, but specifically, they reckon without equity withdrawal by owners of appreciating land. Equity withdrawal means consumption without production—this is dissaving, or *negative* capital formation in the private sector. It is not offset by the rise of land prices, because that is not production or capital formation, it is merely redistribution. A land boom, as we said, is a zero-sum prosperity.

This concern with equity withdrawal is now several years old, but pundits and forecasters have muddled and silenced it in the current depression, as one after another regresses to demand-side idiom and praises equity withdrawal as "supporting the economy" by raising consumer demand. This is a remarkable surrender of "supply-side economists" to demand-side reflexes, with no formal furling of flags, but only the desperation of those who thrash around to explain events they do not understand within their new mental template. We, however, will continue to treat equity withdrawal as a drain on national capital.

To the extent that economists have acknowledged this problem, it is mostly with homeowners (Muellbauer; Poterba et al.) and credit card consumers (Peterson). However, the same logic that sees homeowners' equity withdrawal as dissaving applies equally to businesses that let their buildings depreciate without setting aside Capital Consumption Allowances (CCAs) to maintain their capital. Business owners can do this because the land under their buildings is rising to maintain their assets, and substitute for proper CCAs. Thus they are withdrawing equity by turning old businesses into "cash cows." Only a few economists or business journalists have acknowledged or analyzed this problem (BW article?).

To analyze and understand such negative capital formation we need to distinguish land value from capital value. This is something hardly any economist has done, leaving a void.

Another kind of negative capital formation, silent and menacing, is the decay of our overstretched public infrastructure. Politicians whose monomania is to slash all public spending seriously aggravate this problem.

Other drains on capital are the unreaped harvests of idle and underused land. Once we elect to value land inputs at their o.c. values, all excess of the o.c. of land over the net income it yields its owner is a form of either imputed consumption or outright net loss and waste. This concept is so alien to current modes of thinking and accounting that we do not insist on it now, but only hint at the great waste to be disclosed when we measure the misallocation of our lands, and the great wealth that lies latent at our disposal by putting good land to better use.

G. There is an escape from these dilemmas: make more use of land as a tax base. There is a long tradition of economists noting that land taxes do not drag on or distort good incentives, and actually weaken bad incentives to hold, withhold, and amass land unproductively. Economists have long known, and to some extent even understand, this tradition, but are conditioned to suppress, dismiss, and even deny it. They have not refuted or formally abandoned it—that is too hard. (A few have tried, but only weakly.) It is still here when we need it; we surely need it now. Give names, and their arguments.

Many economists repeat a careless old slogan, couched in abstract terms of art, that we can have equity or efficiency, but not both. It's just another trade-off, they say, beguiling in its simplicity and balance. Tax policy must always be either inadequate and regressive on one hand, or egalitarian and destructive on the other. Concretely, they are saying that to attract jobs and industry we must starve the schools, close the libraries, leave potholes to widen, and pamper the rich. This slogan is ill-thought. It dismisses by silence the revenue potential of taxing land, a policy that gives us efficiency and equity, jobs and capital formation, all together.

H. Many economists believe land revenues would be too meager. That is the reason they give, at any rate, for passing over such a beneficent and powerful reform. Now, however, American legislatures are cutting most tax rates anyway, with nothing at all to replace them. At first their favored theorists hoped and promised that lower rates would yield higher revenues (Laffer Effect), but as this has proven too wishful they are simply proposing to cut more (Einstein's Insanity Principle?). They offer little but borrowing to replace tax revenues in the short run, and nothing in the long save the Laffer Effect (aka dynamic revenue forecasting) to overcome lower tax rates.

They are thus backing into a radical H.G. situation by a conservative route—something Arthur Laffer may even have dimly foreseen, for on his way to inciting Reagan's fiscal revolution he quoted H.G. often, on the damage done by taxing production, capital, and exchange. When H.G. first wrote, spokesmen for power and property feared him as a radical spender who would raise taxes. Some, like the champions of Proposition 13, still see him that way. After about 1920, however, political leaders themselves began to develop more destructive taxes, such as George had condemned, to substitute for property taxes. Leadership evolved along high-tax, big-government lines, especially from 1940 to 1980. In this period the power elite "did a one-eighty." They wanted tax money to fight Nazism and Communism. Some administrations even wanted to fight poverty at home, although that goal has slipped out of fashion today. In the years of big government, dominant economists and their apostles opposed H.G.'s ideas as giving up too much revenue.

During the 1980s, we entered a peace-dividend era, or so we fondly thought. A new power and intellectual elite, the supply-siders, ascended, along tax-cutting lines. They preached Laffer-curve ideas as articulated and implemented, for example, by Lawrence Kudlow, Stephen Moore, Lawrence Lindsey, George Shultz, and Michael Boskin. Shultz and Boskin, retired from Washington to the Hoover Institution, now are playing the same recording for their client Arnold Schwarzenegger, candidate for governor of California. They played it in 1994 for Governor Pete Wilson, heading an advisory board with the tendentious title of "Task Force on California Tax Reform and Reduction." (Hoover ideology is fixed and hardly bends to circumstances, but Wilson had to balance a budget, and raised taxes anyway.) In January, 2003, Boskin even wiped out future federal deficits in a paper he circulated. *Barron's* and *Business Week* declared that the deficit fears had been laid to rest; but Boskin had to recall the essay hastily when critics demolished it (*New York Times*, 27 July 03). Now, as these Laffer-Lindsey-Shultz-Boskin revenue projections prove too optimistic, we are left with sharply trimmed tax rates on capital and its income, as H.G. prescribed, but no revenue safety net, and no tax curb on land pricing. This leaves a void below the flying trapezes, and a clear and urgent need for the rest of H.G.'s proposal, a tax, or set of taxes, on land value.

I. Solid research to back up this dismissal of land tax revenues is lacking. Most modern economists have neglected the matter, or simply cited others whose research is scanty, or obsolete, or partial, or casual, offhand, incidental, and of low quality. Some of it comes from think tanks funded by and sensitive to the viewpoints of major landowners. On the whole it seriously understates the revenue potential of land, mostly through errors and biases we will identify and correct, and we hope make obvious.

J. Many simply oppose all taxes. It somewhat complicates matters, and may bewilder those who are new to these issues, that anti-Georgists come in two forms: those who seek more public revenue and those who seek less. In this work we address those who seek public revenue, at least enough to pay our bills, and stop our slide into debt slavery. It is important to understand, however, the views of those who seek less revenue, for they are numerous and visible and audible on talk radio and the hustings, powerful both in Washington and Peoria, and strong in their faith.

They are symbolized by the "neocons," like Irving Kristol, Jude Wanniski, Grover Norquist, Edwin Feulner, and their fellow-thinkers. Their philosophy is to curb government spending by cutting all tax revenues, regardless of public debts incurred. They dismiss public debts by citing the "Ricardian Equivalence Theorem," which has private saving automatically rise to offset government dissaving. They dismiss government bankruptcy as an unfortunate but necessary step to curb government spending, especially for welfare.

Jon Coupal, President of the Howard Jarvis Taxpayers' Association, still sees property taxes as a menace, which to repel he would sacrifice democracy itself. "If you lower the 2/3 vote requirement [of Proposition 13] you are essentially allowing those who don't own property to levy taxes on those who do." It would be a "disaster" for property owners. People of this stamp warn gravely against "the tyranny of the majority." Coupal favors government by special districts in which only landowners can vote, a return to the days before universal manhood suffrage. Such spokesmen overlook the role of property taxes in obviating other, destructive kinds of taxes. Coupal's views are relevant to us in supporting the view that property taxes can yield large revenues. That is clear enough in modern California, anyway, where cutting property taxes has led first to raising many other taxes, and next to the current deficit and fiscal disaster. It takes a powerful dogma to screen out evidence as strong as this.

James Buchanan of the "public choice" school does not overlook George's strictures against destructive taxation, but has a more complicated reaction. He understands the strictures well, but turns them on their head. Buchanan holds that the best tax is the most destructive, most hateful tax, because that will help minimize public revenues, which he believes are worse than wasted. He therefore opposes taxes on land values precisely because they are so good, i.e., they can raise so much revenue with so little collateral damage.

If one's goal is a state-free society, and if one believes it could work, that is, at least, consistent. It is not clear, though, that most of Buchanan's cohorts embrace that ultimate goal—certainly not enough to declare openly as fire-breathing anarchists. They are content to bait and trash bureaucrats, always a popular amusement that requires little constructive thought. The de facto role of Buchananism is to give a patina of philosophical depth to the eternal political position, beloved by "out" politicians wanting "in," that the panacea lies in harassing and auditing wastrel "bureaucrats," and cutting their budgets, without troubling to observe or evaluate what they actually do, and what powerful constituencies of private landowners make them do it.

Without endorsing or denying waste, arrogance, and self-aggrandizement by bureaucrats, it is a dangerous illusion to scapegoat them alone for modern deficits. Among other things, anarchism overlooks the frighteningly huge capital requirements of repairing and replacing our neglected public infrastructure, from which we have been draining social capital for decades. It overlooks the fiscal needs of our self-appointed job of policing the world, fighting “drugs” and “terrorism,” and installing our firms to monitor and exploit other countries.

My subject here is changing the tax system, not wiping out public services. My subject *per se* makes no choice between public and private education, which is a separate issue on its own merits. Ditto for social support of medical care, or aid for the parents of handicapped children. The question here is how any given level of public services shall be funded. The task of this work is to ask if land-value taxes can raise enough revenue to support the modern state: to address the concern of revenue adequacy. Buchanan’s views are relevant to us here as supporting the view that land-value taxes can raise ample revenues while wreaking no collateral damage, even at high tax rates.

We will also be pointing out how shifting to taxes on land values will abate much of the incentives and excuses for waste in government, from Boss Tweed to Paul Wolfowitz (refer to V, below).

K. Overlapping with the neocons and public choice theorists, there is a powerful school of thought whose champions would untax all property and property income, to tax only workers and “consumption” (poorly defined to exclude consumption of land). It includes Robert Barro, Daniel Mitchell, Paul Craig Roberts, Stephen Moore, Robert Hall, and Alvin Rabushka (the Flat Tax), Laurence Kotlikoff, Joel Fox (Howard Jarvis Taxpayers’ Association), Charls (sic) Walker (American Council for Capital Formation) and his stable of stars like Michael Boskin, Douglas Holtz-Eakin, Glenn Hubbard, Gregory Mankiw, Burton Malkiel, and Murray Weidenbaum, with occasional assists from supposed moderates like Brookings economists Henry Aaron and Harvey Galper with their “Cash Flow Tax.” Congressmen like Tom DeLay, Richard Armey, William Archer, Billy Tauzin, Steve Largent, Ron Paul, presidential candidates Philip Gramm and Steven Forbes, and many others lend political weight. CATO, Heritage, Hoover, AEI, and the whole panoply of property-oriented, property-funded think tanks lean their way and publish supportive research. The media, themselves seized of valuable lands and licenses to protect, publicize such opinions freely.

Most of the above write and speak in favor of capital formation and free markets—that is their professed worthy goal—but their actual proposals exempt land and its income from taxation, while burdening and gumming up free markets themselves with sales and payroll and income taxes. This smells like an aggravated case of hiding the real reason behind the good reason. We need to reconsider their allegations with respect to land.

The degree of leading economists’ concern for those crushed under George’s “immense wedge” may be gauged by their declaration of August 2003 that the current depression was over. Not only that, it had been over for nearly two years, since November, 2001, we just didn’t notice because of all the layoffs, and the rising numbers of people below the poverty line. Robert Hall, chair of the NBER Committee on Dating Business Cycles, explained that “the economy” is doing better. His measure and definition of “the economy” is the GDP. Such is the reverence for the authority of the NBER that ever since its astounding announcement in August, the media have slavishly repeated that the recession “officially” ended in November 2001.

Economists and pundits comment often in 2003 that it is unusual for employment to fall as GDP rises. Actually, this goes back to the 1980s at least, when the term “jobless prosperity” was coined. No one should feign surprise today at a trend that is a generation old. “The recession ended in 1991,” reported the AP in 1994, although declining wages overrode the positives, such as economic growth. "Full-time workers experienced a significant drop in income last year, *a pattern similar to that of the 1980s*," said Isaac Shapiro, Center on Budget and Policy Priorities. "Income growth seems to be concentrated among better-off Americans. The *long-term* trend in the U.S. has been toward increasing income inequality." (Daniel H. Weinberg, Census Bureau, Chief Housing and Household Economics Statistics Division.) (Randolph E. Schmid, AP, 1994, "39 million Americans below poverty level," *The Press-Enterprise*, Riverside, 9 October, A-20.)

Actually there is nothing “official” about the NBER, and its opinions may be tinged with subjectivity. Robert Hall is co-author of *The Flat Tax*, “Bible” of the movement to exempt all property income from taxation. In the age of Keynes and Alvin Hansen and the Full Employment Act of 1946, full employment of labor was the prime goal of public policy and the prime concern of professional economists as writers, teachers, and advisers to statesmen. Today, it is of only incidental interest to the NBER Committee that the United States has lost two million or more jobs since the brief recession of 2001 “ended.” This is not just an oversight. The media turn to Hoover for interpretation. “Job Loss? Good!” headlines David R. Henderson, citing his colleague Robert Hall at the Hoover Institution. “The loss of manufacturing jobs is a sign of economic health. … That is a hardship for workers … But they find work elsewhere ... (to) increase our standard of living.” (Henderson, TPE A11, 9 Sept., 2003). Robert Barro voices the same sentiment. “Negative employment growth” means higher productivity, from which “the economy” will benefit tremendously” (*Business Week*, 29 Sept 03, p.30). To these economists, “The Economy” has become an idol of theological power. “The Economy,” measured by GDP, includes unearned incomes, but they are as countable as earned incomes, so the economy may improve while earned incomes fall. The jobless should retool themselves with advanced degrees, and if MBAs and PhDs are going begging, well, there will be pie in the sky. According to Barro, employment depends on “labor force participation,” a covert way of saying that unemployment is voluntary—a worker’s decision not to participate.

Approval of unemployment is also “socially correct” in “The Perspective from the Santa Barbara Polo Club,” nine acres of velvet green turf on some of the priciest land in the United States, kept green with some of the scarcest water. Quite an ecological footprint, it would seem, but it is others’ footprints that concern its members. Reporter James Rainey quotes player Carlos Fairbanks, relaxing with a flute of champagne between chukkers: “The more jobs he (Gov. Davis) chases out of the state, the better. If we could shed a few people, we would be much better off.” Others whom Rainey interviewed reside in Santa Barbara only part time, when not in their second (and third, fourth, fifth?) homes in Europe. (*Los Angeles Times*, 12 Sept 03 p.1.)

We will also be pointing out how good tax policy leads to better use of any given stock of capital, having even better effects, at lower cost, than creating more capital.

L. A problem with the prescriptions of Barro, et al., is that we have already lowered taxes on wealth without achieving the promised capital formation. Landownership has become virtually exempt from income taxation. We will show that it often even enjoys negative tax rates. It is also often a means to shelter other incomes from the tax. Yet, national governmental spending does not fall, as some have fondly hoped. We have simply replaced “tax and spend” with “borrow and spend,” a more extreme form of prodigality. The deficit itself soaks up savings that would otherwise form private capital. As to the Ricardo Effect, unearned increments in private hands lead to massive “equity withdrawal,” which is social dissaving.

State taxes on property, which in 1920 comprised a large share of state revenues, have fallen nearly to zero. So land now contributes little to national or state revenues.

Local property tax rates and coverage have dropped well below historic levels. The leading state of California, long above average in its rates of property taxation and support of public schools, has fallen since 1978 (Proposition 13) to become an incubator of illiterates nurtured in schools on a par with Mississippi’s and Alabama’s. Land values are not lacking; they are the highest in history. California landowners wallow in unearned increments beyond the dreams of avarice, while its public bodies court bankruptcy. What is lacking are land assessments and substantial tax rates.

The Barro School, however, take the failure of their policies as evidence that more is needed. In this they rather resemble the Okun School of the waning days of the Carter administration, and the Mellon School of the dying days of the Hoover administration, and failed schools of politico-economic thought through the ages. “All political parties die at last of swallowing their own lies” - Samuel Arbuthnot (1667-1735).

M. Our central question then remains: can land yield enough revenue to replace most other taxes? As we plunge into the details of the evidence and analysis, bear in mind the grand objectives.