# REDUCING TAX
# OBSTACLES
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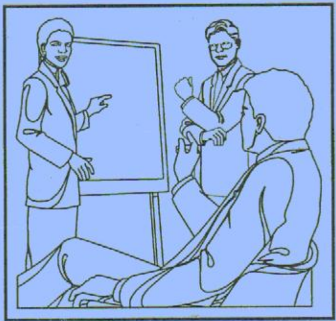
*An Address*

*By* C. Lowell Harriss



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# Reducing Tax Obstacles to Economic Progress:

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*By* C. LOWELL HARRISS*

I

### The Vision of Henry George

NO TAX ON LABOR. No tax on man-made capital. Government to be financed from the fruits of land—land, the product of nature, not of human effort or thrift! Land which will continue to serve no matter how much of the production attributable to it is taken by government.

Such was the vision of Henry George (1839-1897). A century ago his proposals had wide public support—The Single Tax on land "and the abolition of all taxes upon industry and the products of industry" (George, *The Standard,* Aug. 3, 1889). Let me repeat: No tax on labor or man-made capital.

At that time a tax on pure land rents (in the classical economic sense) might well have paid for all of American government. (I assume some way around Constitutional restrictions.) The national government and the states did very little by present standards. Government was local.

Looking at the figures, one must be cautious if only because of changes in the purchasing power of the dollar (inflation). Yet a few numbers may be helpful. We have the findings of the first Census of Governments (1902, not long after George's active life). They cover all three levels of government—local, state, and national. The Census found that taxes for all units of government combined were $1,373,000,000 in 1902. Property taxes were $706,000,000, over half of the total. A near doubling of the property tax (to pay for total spending) with all revenue coming from land while removing all taxes on buildings and personal property would have involved considerable shifts away from man-made capital and onto land. But such a change—to a Single Tax—would, I believe, have been economically possible. (The two largest non-property taxes were $243,000,000 from the tariff and $187,000,000 from taxes on alcoholic beverages.) Per capita taxes for all levels of government were about $18.60. Total taxes were slightly less than seven percent of personal income.

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Such figures help us to understand that Henry George was not the impractical dreamer sometimes apparently assumed by persons who dismiss his views as too unrealistic to deserve respectful attention.

Government services were chiefly local, paid for almost entirely by property taxes. A portion came from land. Enough more might have come from the land portion to permit a relatively large drop in, even the elimination of, property tax on man-made capital. Our choices today do not include a single tax to replace taxes on labor and capital. However, our choices do include the opportunity to reduce burdens on man-made instruments of production—factories, houses, utility plants, computers, transportation facilities, commercial buildings, business inventories, and so on.

II

## Total Land Values in the United States

HOW FAR COULD LAND VALUE TAXES GO toward reducing today the burdens on industry, on production, and on persons as consumers? Significantly, but far from completely!

For the purposes of this paper I shall exclude oil and other minerals. The principles involved would call for inclusion of the natural resource value of minerals extracted. It would be appropriate to include the value of air rights as an element of location to the extent not included in land values. Land values depend on current and prospective benefits—economic rents—capitalized at some rate of interest. The Federal Reserve BALANCE SHEETS FOR THE U.S. ECONOMY 1945–92 shows "land at market prices" at the end of 1992 as $4,289 billion, around $16,000 per capita. (Governmentally owned land is excluded; it would not, one assumes, constitute part of a base for taxation.) The 1989 figure had been larger by one and a quarter trillion dollars—$1,265 billion; land values dropped by one third in three years. The 1977 total is shown as smaller by two and a half trillion dollars—$2,460 billion. The changes in 15 years were indeed large.

Land made up an estimated 23.4 percent of domestic wealth in 1992. The degree of error in these figures must be large. But, in any case, land totals are substantial.

An additional tax of one percentage point on land value apparently would yield somewhat under $40 billion a year. This amount would be more than one-fifth of the $174 billion total property tax revenue in 1992. In most localities an annual tax of five to eight percent on full value of land would probably finance the complete elimination of property taxes on man-made capital. Obviously, any such estimate is subject to a wide range of uncertainty if only because we cannot know how the shift would affect land prices. Nor do we know how much of the land included in the total would be exempt on the basis of its ownership by religious and other tax exempt institutions.

No immediate, abrupt freeing of buildings, machinery, and inventories from property tax lies in the realm of probability. But over the years, not necessarily many, the phasing out of tax on man-made capital does seem possible—economically. Legally, and politically, change presents a variety of problems. Many state constitutions would have to be modified. Leaders, and then the public, would have to be instructed and convinced, community by community, state by state.

## III

## Some Fundamentals

THIS AUDIENCE will be familiar generally with many of the important aspects of theory and practice of property taxation in the United States. But I shall venture a few points that relate to what seems to me to be essential for understanding the potential for improving the well-being of Americans as well as that of persons in many other lands.

1. In an economic sense "the" property tax consists of two elements. They differ substantially. One is land as the product of nature. The other consists of things men and women have produced.

2. In the United States "the" property tax differs from state to state and from locality to locality. To generalize responsibly is risky; innumerable special elements differentiate property taxation from one place to another. States may act independently; so too may localities within many states.

3. A tax system is a human institution. What exists has been created by men and women. It can be changed.

4. Taxes bring revenue to governments. And taxes do more. They influence the ways individuals, businesses, and other institutions carry on their affairs. The non-revenue effects can be large and small, obvious and hidden, direct and indirect, and of many types. Different tax structures that yield the same total revenue can have significantly different non-revenue results.

5. Taxes take without ordinarily giving the specific taxpayer anything identifiable as a result. There is striking contrast with prices and the market transactions that they make possible. In an exchange in markets there is a *quid pro quo.* Where taxes are involved, in contrast, the individual, quite generally, gets neither more nor less service if he or she pays more or less tax.

Sometimes it is better for the taxpayer to arrange affairs and accept results that in a fundamental sense are second- or third-choice ones in order to save on taxes. There is loss since the resources involved could have been used to better advantage in the absence of taxes. The government treasury loses. So does the taxpayer. But the taxpayer would be worse off had he chosen the inherently most productive alternative and paid the higher tax. The economy produces less than it could. The real burden of the tax exceeds the dollars the government receives. There is an "excess burden," one largely hidden and unmeasured.

IV

### Effects of Taxes on Structures on Well-being

HUMAN WELFARE can be improved by reducing the tax on structures. Two percent or so a year levied against their capital value, not the income they produce, will usually be large relative to that income. A tax at this level would be a considerable burden. For the record, when I say "structures" I include other man-made capital—telephone, electric, other utility facilities; computers; machinery and equipment; trucks and planes; inventory of business; and so on. Stocks, bonds, bank accounts, and other intangibles, however, are excluded.

Buildings will come into existence and will be maintained only if someone with resources expects to get as much net benefit from providing and maintaining them as is obtainable elsewhere. Buildings are long-lived. Decades may be required for the person committing resources to get back amounts equivalent to the original outlay above and beyond an appropriate annual net yield.

Similarly, production equipment must also meet the test of prospective benefit after tax.

Will users pay enough so that the owner can meet operating costs and get a net income (net benefit in the case of owner-occupants) at least equal to alternatives? The higher the property tax on the structure, the greater the obstacles to be overcome. Note that the higher this tax, the fewer the cases that can jump the tax hurdle. Thus property taxation operates to make for a smaller quantity of housing and other man-made capital.

Their quality also suffers. The tax induces smallness in structures, buildings and rooms, as compared with what would be built if there were less or no tax. Society, human beings, lose because of the reality of the "law of the cube." Cubic content differs more than in proportion to the dimensions of walls, ceiling, and floor. What people want is living space, not merely the walls. Per unit of space, the costs of plumbing, electricity, heating, and other facilities tend to decline as the space increases. The property tax on structures, by raising costs of occupancy over the lifetime of a building, induces the construction of smaller units. The "saving" in labor and materials neither saves government expenses nor brings revenue. Consumers have less for living.

The property tax on buildings also discourages maintenance and improvement. We have absolutely no way of knowing by how much. But the tax must discourage actions that people, acting freely, would make to better their lives without harming others and without adding to the costs of government. The property tax on man-made capital has other adverse effects. Business policy and practice on inventory are sometimes distorted. From various effects the tax on structures brings excess burden, deadweight loss. People lose in benefit more than governments receive in revenue.

A regressive element exists. We do not know with confidence how the burden affects persons with different incomes, but families with low income are likely to be burdened more than many of us would consider desirable.

V

## Property Taxes on Land

GOVERNMENTS can reduce the adverse effects of taxes on structures by cutting applicable rates and making up the revenues by higher rates on land.

Land owes its existence to nature, not to human effort. No incentive is necessary to get the present stock created. It exists—and not because of human effort in the sacrifice of other alternatives. (Some will point out that considerable efforts have been involved in opening frontiers. But these costs are "sunk" and now are remote from the problems of obtaining space for modern life.)

With minor exceptions, the amount of land today does not depend upon incentives to produce land. But the quantities made available for one, as against another use can be affected by relative prices, rents, incentives. Land has a crucial role in life. But unlike other factors of production the quantity of land will not decline if the net income after taxes drops, nor will its quantity rise if payments for its use increase. In this respect land has unique characteristics.

In cities over the world users of land pay more (in prices adjusted for inflation), often very much more, than was required a decade or a generation ago. The higher payment has not gone to create more land.

Inflation-adjusted increases in land prices (and allowing for capital spent to improve a site) result, in part, from the growth of population. Other reasons include community change, government spending on streets, schools, utilities, and other facilities. Business development can make neighboring sites (land) more or less desirable. Changes in technology and in consumer taste also affect desirability.

Landowners may become richer while they sleep. But sometimes landowners do devote capital, labor, and entrepreneurship to make their land more desirable. The distinction obviously relates to incentives. There is no need for society to provide incentives for the passive owner. Development effort, however, deserves respect and not discouragement.

The pure economic rent offers an attractive potential as a source of revenue to finance (local) government. Higher tax would not induce the owner to reduce the amount of land (as space on the earth). The quantity of space in the area would not decline. In this respect, to repeat, land differs from other productive resources.

The tax can, however, affect the use made of parcels of land. As a general matter, of course, owners should make the best use possible of land whether their tax is high or low. But, as a practical matter, the need to pay tax in cash each year can provide incentive to put land to use earlier than it would be otherwise, or to move it to a higher and better use thus beneficially serving the community!

## VI

## The Proposal

GOVERNMENT SHOULD REDUCE THE TAX RATE on structures and raise the rate on land enough to keep revenue stable. More sweeping change could be recommended, *e.g.*, replacing some onerous non-property taxes. My proposal is a starter.

Most homeowners and some other property owners would not experience much change in tax bills. Indeed, some studies of the results when cities adopt a split-rate tax find that a large number of homeowners get some tax reduction. Owners with exceptionally fine improvements—an outstanding building or well-equipped factory—would generally see their taxes going down. Owners of vacant land would get higher tax bills.

Capitalization of the higher tax on land would reduce its price. Price increases on structures and machinery from capitalization of their tax reduction would be restrained by the reproducibility of man-made capital.

Improved net yields of man-made capital would tend to increase the demand for land and thus benefit some landowners. And so on. The variety of change would differ from one case to another and depend upon the rate differentials.

Two kinds of beneficial results can be counted upon. Reduction in the adverse incentives for new construction and for installing new man-made capital will improve housing and production capacity. More than insignificant pressure on owners of land to put it to the best potential use indicated by market conditions will benefit the general public.

## VII

## Why Have the Benefits Not Been Seized Upon?

THE CASE FOR REDUCING THE ANTI-PROGRESS TAXES on structures and getting more revenue from taxes on land were made so very clear by Henry George that one asks, "Why were the opportunities not utilized long ago?" I do not know enough about the conditions of his time to presume a responsible conclusion. My guess is that much of the explanation lies in lack of active, focused support from those who would have benefited.

Most businesses, I believe, would have profited; but some, at least, were doubtless repelled by his opposition to protective tariffs and his antagonism to monopoly. His sympathy for labor unions probably aroused opposition. So did his belief that the land owned by churches should not be tax exempt.

There may have been no concentration of prospective benefits to create a "fighting" impulse in this state or that, this community or that, to mobilize decisive political pressure. Benefits would have been diffused widely—large in total but small for each voter as an individual. But even for individuals, they would have been very large over time.

Another guess is that an unduly large amount of attention was directed to the "anti-landowner" aspect and not enough to the pro-production (pro-business) aspects. And at the time other issues, *e.g.*, gold and silver (money), monopoly, and the tariff, absorbed attention.

The great potentials were those of public policy as against interests of individuals. Mobilization of support for public policy takes considerable devotion and, in a sense, self-sacrifice.

VII

**Thoughts on Conditions of Today**

As one thinks of the enormous rise in land prices (after allowing for inflation) since Henry George's time, and dreams of the benefits for local government finance if much more of the rise had gone to paying for education, policing, and other local services, might one not say, "Let us stop the loss of opportunity?"

Alas, good ideas are not self-fulfilling. Someone must act. Human beings must make efforts. And the rewards to individuals will be overwhelmingly a sense of satisfaction, not economic benefits that help the family finances.

A major shift of emphasis should be away from talking about the land tax aspects—higher burdens on land values—and toward reducing tax burdens on man-made capital. George himself spoke eloquently of lifting crushing burdens on business. Such is a positive goal. I suggest that we make more of this. Some years ago advocates of "supply side" economics did focus on the good results to be expected from reducing taxes on income. Rates were reduced. The 1980s witnessed widespread prosperity. Today at least some of the public may have considerable receptivity for the notion that human beings can, and some will, react positively to tax rate reductions. And, of course, react negatively to tax rate increases, except in the case of land, the supply of which is fixed since a tax increase on it will tend to induce "higher and better" use.

Who would benefit from the reforms here advocated? Everyone, almost. A warning, however! One can "promise" too much. The chief transmission of forces for general public benefit would be an improvement in the supply and allocation of man-made capital. There is evidence of such positive results in the Pennsylvania communities that have adopted two-rate taxation. But the results depend upon the attraction of more capital. From where? For individual communities the clear opportunity is that of attracting capital funds in the market. If a large number of localities moved at the same time, the increased demand for savings would raise interest rates and create adjustment problems. Such is not a prospect for the foreseeable future.

One can think of groups likely to witness more benefit than the average. Business managers, would, I submit, find doing a good job easier as property taxes on buildings and machinery decline. All of us in our capacities as consumers would gain but usually in no identifiable way, except perhaps in housing. Modernization and new construction might well change enough for their beneficiaries to see a connection.

Groups that might see some early connection would be workers in construction, architects, producers of machinery, and doubtless others.

Who would suffer? Although there would be net benefits, there would be some losers, and fears on the part of others. The results would depend upon the change in demand for land due to an increase in the potential profitability of new and better buildings and use of machinery. Owners of essentially vacant and substantially underused land would face new conditions.

It seems to me that large changes, while desirable, ought to be made more gradually rather than suddenly.

Resistance may arise from skepticism among voters. Would tax rates on man-made capital really go down enough to match increases in rates on land? Somehow assurance should be provided. My proposal involves revenue neutrality. Voters could choose something else.

## IX
## Concluding Comments

PROPERTY TAXATION plays a crucial role in financing the supply of local government functions. In many places the rates are already high enough to have non-revenue effects of significance. Much of the adverse force of these effects can be mitigated. Indeed, incentives to improve land use can be part of the program. The tax can be related to capital value as in the United States and Canada, or to annual yield. The latter avoids the problem of the effects of rising tax rates on the size of the base. The choice should rest upon conditions of time and place.

One might well support greater change. For example, I believe that eventually the allocation of much, but not all, pure land rent to pay for (local) government would be to "our" benefit—a condition to be achieved gradually.

But Henry George's insights can serve us well today.

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