# The Tax Solution

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Sunday, May 12, 2013 H. William Batt, Ph.D.,
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The current attitudes toward government and its accompanying fiscal malaise can be explained in good part by the groundswell of resentment people feel about paying taxes. The dilemma has its roots, I believe, in the economic paradigm dominating public thought and discourse for the past century. People resent paying taxes for good reason. Most taxes discourage economic vitality—taxing sales reduces consumption; taxing wages discourages work; taxing interest reduces savings—and so on. But there is one exception to the impact of taxation: taxing a base with an inelastic, or fixed, supply. Such taxes engender growth and economic vitality.[1] Here the greater the tax the more the activity. Recently Professor Joe Stiglitz wrote

> One of the general principles of taxation is that one should tax factors that are inelastic in supply, since there are no adverse supply side effects. Land does not disappear when it is taxed. Henry George, a great progressive of the late nineteenth century, argued, partly on this basis, for a land tax. It is ironic that rather than following this dictum, the United States has been doing just the opposite through its preferential treatment of capital gains.

He goes on to say:

> But it is not just land that faces a low elasticity of supply. It is the case for other depletable natural resources. Subsidies might encourage the early discovery of some resource, but it does not increase the supply of the resource; that is largely a matter of nature. That is why it also makes sense, from an efficiency point of view, to tax natural resource rents at as close to 100% as possible.[2]

The word rent as it is used by economists has all but disappeared from the vocabularies of the general public. It is sometimes called Ricardian rent (after classical British economist David Ricardo), ground rent, or resource rent. Rents, one needs to know, are the yields that flow from wealth not created by human beings but from nature. What market prices they have occur only after there is an economic demand for them. Once they are no longer free goods and command a scarcity value, they typically become owned, then to be bought and sold as commodities. What is arguably the common birthright of all humanity, and has been in most civilizations since time immemorial, has in the last three centuries turned into a “land grab,” ratified by governments as the sacrosanct privilege of property ownership. No distinction is made between ownership of one’s car, one’s computer, or one’s house, as opposed to land, air, or water. In the modern western mind it has all become property. But nature’s flow of rents still exist, even when understood in capitalized form, and it is now captured for privileged gains. That wealth and value becomes a windfall gain to whomever is the titleholder, a “free lunch.” It is unearned income.

If we taxed these "resource rents," they could totally supplant other revenues streams that are such anathema; in fact taxing rents is essentially painless. This is because their source is "the commons," socially created wealth that arguably shouldn't be private in any case. "The earth," Jefferson wrote, "belongs in usufruct to the living; the dead have neither powers nor rights over it."[3] Usufruct itself is a term lost to today's discourse: it means to own something provisionally as leasehold. Land ownership in fee simple is the anomaly in world civilization, only having taken hold beginning in the 17th century.[4] In most times and places nature in whatever form has been held in common, and rents were collected from users.[5]

Rent is the perfect tax base, as it comports with all the textbook principles of sound tax theory. A land value tax is completely neutral, totally efficient, highly progressive, easily administered, reliably stable, simple to understand, and impossible to avoid. Secondly, because rent that flows through site parcels is socially created value, there is sound moral ground for society to collect that which it has created. This then leaves to members of the community the full retention and ownership of their labor wages, as well as any products of their labor for which they are responsible. When the flow of rent is not taxed it remains as frozen capital, thereby reducing the velocity, the turnover, of potential capital circulating. Thirdly, it reduces the "throughput" of natural resources that otherwise obtains by use of other tax regimes. With resource conservation in mind, a tax on ground rent fosters efficient land use configurations. The centrifugal forces of sprawl development are reversed, along with excessive reliance upon transportation from one place to another, and thereby consuming inordinate quantities of natural resources, materials and time.

Adam Smith, writing in 1776, observed, "Ground-rents and the ordinary rent of land are…the species of revenue which can best bear to have a peculiar tax imposed on them."[6] He understood, along with the French Physiocrats by whom he was influenced, that rent was common wealth and that it in no way impaired productivity. At that time landed property was the only element of nature that commanded a market price; today there are many commodities that are titled to individuals or corporations that make them wealthy. But this wealth is totally unearned; it is a function of a government granted privilege with questionable moral grounding. Examples of other such grants are the bestowal of spectrum frequencies to the broadcasting industry, the granting of timeslots for airlines to land and take off, and the awarding of water rights – usually at far less than cost – for agricultural, industrial, or power generation purposes. Other resources with market value and should be part of the public domain are the genetic code, fossil fuels and minerals, patents and copyrights, satellite orbits, various languages and codes, and of course seignorage – the coining of money.

If the "public owns the airwaves," as we frequently hear, they should be auctioned off periodically to the highest bidder rather than ownership be perpetually grandfathered as originally granted in 1928. We now read that the air-sink itself may soon be given to the power utilities for release of pollution emissions to the extent that natural absorption allows. Rather than cap-and-trade, the air-sinks should be regularly auction-rented to the highest bidders, and their rental income used for public purposes.[7] There are so many elements of nature that today have marketable value that the rental income they provide could easily take the place of taxes on our labor. Unearned income is the rightful source of public revenue because the earth is the common heritage of humanity.

But the public hardly understands the concept of rent as the term is used in old economics; it has been largely extirpated from its literature except among those that know classical economics and the work of Henry George and his acolytes. Professor Mason Gaffney has traced how formulas and definitions were changed so that the term rent became a trivial factor for today's neoclassical school. In his book *The*

*Corruption of Economics*,[8] Gaffney shows that only by recognition of rent as a factor of production is the economy really comprehensible or indeed manageable. His subsequent work shows that the extent of rent from all sources is more than adequate to provide revenue in support of public services.[9] This is corroborated by the empirical analysis elsewhere where data on resource rents can be garnered more easily.[10] Because the economic profession neglects to take account of this wealth,[11] our tax structure is also able to ignore it. This enables some people to capture rents with relative ease and without scrutiny.

Dr. Stiglitz has noted in his most recent book the extent to which our economy has been distorted, indeed corrupted, not just by treating unearned income in the same way as that which people earn by brain and brawn, but even by giving it special status by taxing it at lower rates! Rent seeking has reached proportions in American society that make it a high art. “We have a political system,” he says, “that gives inordinate power to those at the top, and they have used that power not only to limit the extent of redistribution but also to shape the rules of the game in their favor, and to extract from the public what can only be called large ‘gifts.’”[12]

He then shows that, “The bottom 90 percent of the population gets less than 10 percent of all capital gains. Under 7 percent of households earning less than $100,000 receive any capital gains income, and for these households capital gains and dividend income combined make up an average of 1.4 percent of their total income. Salaries and wages accounted for only 8.8 percent of the income of the top 400, capital gains for 57 percent, and interest and dividends for 16 percent—so 73 percent of their income was subject to low rates. Indeed, the top 400 taxpayers garner close to 5 percent of the country’s entire dividends.” He concluded that “We have created an economy and a society in which great wealth is amassed through rent seeking, sometimes through direct transfers from the public to the wealthy, more often through rules that allow the wealthy to collect ‘rents’ from the rest of society through monopoly power and other forms of exploitation.”[13]

Henry George called the private capture of the rental yield from common resources theft! “Thou Shalt Not Steal!” he told the Anti-Poverty Society of New York in 1887. It was as immoral to capture freehold ownership of nature as it was to own other human beings—slaves— as property.[14] Some contemporary economists also view rent-seeking in such a light. Arye Hillman, the author of one current public finance textbook, says, “*Rent seeking* is the “competition for privilege. The form of government affects the extent of rent seeking that takes place…. In general, whenever personal benefits depend on decisions made by other people, life can become a quest for personal favors, and people spend time and effort in rent-seeking activity.”[15] A contemporary economic historian has a still more pointed definition: “the use of resources to get a rent by reducing the welfare of others.”[16] John Stuart Mill saw it clearly almost two centuries ago: “Landlords grow richer in their sleep without working, risking or economizing. The increase in the value of land, arising as it does from the efforts of an entire community, should belong to the community and not to the individual who might hold title.”[17] British statesman William Gladstone called it “lazy income,” and Henry George called it the “unearned increment.”

We have today so corrupted our economic discourse that we fail even to recognize rent, let alone tax it. We even give it privileged standing on the ground that only by allowing wealthy people to retain their unearned increment will investment income be available for financial enterprise. This is nonsense. We have the means of analysis, with computers and better data, to show that our economy would be far more productive, and its members would be far better off, if the public purse were to come from rental revenue instead of our earned income. John Houseman, an actor perhaps most widely known as Professor Kingsfield in the long-running TV series, *The Paper Chase*, later became the pitchman for Smith Barney. In that advertisement, his tag line was “They make money the old-fashioned way –they earn it."[18] That we should earn our money rather than live off the efforts of others seems a simple enough moral tenet. But it seems to have lost its cogency in contemporary economic thought.

Batt CU Presentation2 May 15, 2013 Word Count: 1,950

[1] See, for example, Guerney Breckenfeld, "Higher Taxes that Promote Development," *Fortune Magazine*, August 8, 1983, pp. 68-71. This is reprinted online at http://localtax.com/fortune/hightax.html. (accessed Nov. 2012). In 1995, Professor Nicolaus Tideman of Virginia Tech University and his then graduate student,Florenz Plassmann (now a professor at the University of Binghamton) completed a highly technical study of land value taxation as used in the 23 cities in Pennsylvania using such a tax. It concluded: "The results say that in all four categories of construction, an increase in the effective tax differential [between land and buildings] (1) is associated with an increase in the average value per permit. (2) In the case of residential housing, a 1% increase in the effective tax differential is associated with a 12% increase in the average value per unit.… From the perspective of economic theory, it is not at all surprising that when taxes are taken off of buildings, people build more valuable buildings. But it is nice to see the numbers." See "A Markov Chain Monte Carlo Analysis of the Effect of Two-Rate Property Taxes on Construction." *Journal of Urban Economics,* 47(2), 2000, 216-47. Several other studies show equally dramatic impacts. See also Nicolaus Tideman, "Taxing Land is Better than Neutral; Land Taxes, Land Speculation and the Timing of Development," in Kenneth C. Wenzer (ed.), *Land-Value Taxation: The Equitable and Efficient Source of Public Finance*. (Armonk. New York: M.E. Sharpe and London: Shepheard-Walwyn, 1999): 109-133.

[2] "Principles and Guidelines for Deficit Reduction," The Roosevelt Institute, December 2, 2010, Working Paper No. 6

[3] Jefferson letter to Madison, September 6, 1789. *Writings of Thomas Jefferson*, 1892-99. Ford, Lesson IX.

[4] See, for example, John C. Weaver, *The Great Land Rush and the Making of the Modern World, 1650-1900*. Montreal: McGill-Queen's University Press, 2003.

[5] See, for example, Marc Bloch, *French Rural History: An Essay on Its Basic Characteristics*. (Berkeley: University of California Press, 1966, 1970) p. 72; H.S. Bennett, *Life on the English Manor: A Study of Peasant Conditions, 1150-1400*. Ch. V: "Rents and Services," pp. 97-125, *passim* (Cambridge: Cambridge University Press, 1937, 1971); Paul Bairoch. *Cities and Economic Development: From the Dawn of History to the Present*. (Chicago: University of Chicago Press, 1991, p. 283.
Gerhard Lenski notes, however, that the Chinese Gentry was able at times to collect as much as 40-50 percent of the land yield as rent (*Power and Privilege: A Theory of Social Stratification,* New York: McGraw Hill, 1966, p. 226 and more generally in Ch. 9. Francois Quesnay, one of the most notable of the French Physiocrats, estimated economic rent "to be about one third of the 'net product according to Marc Blaug, *Economic Theory in Retrospect, Fifth Edition*. Cambridge U Press, 1997, p.29. Systems of rents can be traced to ancient times. On manners of payment, see the series of conferences of International Scholars on Ancient Near Eastern Economies. Volume 1: Michael Hudson and Baruch A. Levine (Ed.) (1996). *Privatization in the Ancient Near East and the Classical World*. Peabody Museum of Archaeology and Ethnology, Harvard University; Volume 2: Michael Hudson and Baruch A. Levine (Ed.) (1999). *Urbanization and Land Ownership in the Ancient Near East*. Peabody Museum of Archaeology and Ethnology, Harvard University; Volume 3: Michael Hudson and Mark van De Mieroop (ed.), 2002: *Debt and Economic Renewal in the Ancient Near East*. Bethesda, MD: CDL; Volume 4: Michael

Hudson and Cornelia Wunsch (ed.). 2004. *Creating Economic Order: Record-Keeping, Standardization, and the Development of Accounting in the Ancient Near East*. Bethesda, MD: CDL; and Volume 5: Michael Hudson and CorneliaWunsch (ed.) *Free Labor in the Ancient Near East* (forthcoming). Among more accessible works are Walter Brueggemann, *The Land: Place as Gift, Promise and Challenge in Biblical Faith*, Second Edition. Minneapolis: Fortress Press, 2003; Norman C. Habel, *The Land is Mine: Six Biblical Land Ideologies*. Minneapolis: Fortress Press, 1995; Charles Avila, *Ownership: Early Christian Teaching*. London: Orbis Books, 1983; and John L. Kelly, *The Other Law of Moses*. Peoria, Illinois, 2011.

[6] *Wealth of Nations*, Bk 5, Ch.2, Pt.2., Art.1.

[7] For an example of this, see Peter Barnes, *Who Owns the Sky?* Washington: Island Press, 2001.

[8] Mason Gaffney and Fred Harrison, *The Corruption of Economics*. London: Shepheard-Walwyn Publishers, 1994,

accessible online at http://homepage.ntlworld.com/janusg/coe/!index.htm

[9] Mason Gaffney, "The Hidden Taxable Capacity of Land: Enough and to Spare," *International Journal of Social Economics*, Vol. 36:.4 (2009): 328-411.

[10] Terry Dwyer, "The Taxable Capacity of Australian Land Resources," in *Australian Tax Forum*, Vol. 18:1 (Jan. 2003). http://www.prosper.org.au/Documents/TaxableCapacity.pdf; See also Steven Cord, "How Much Revenue Would a Full Land Value Tax Yield? Analysis of Census and Federal Reserve Data," *American Journal of Economics and Sociology*, Vol. 44, No. 3 (Jul, 1985): 279-293.

[11] Just about any basic economics text will cite a number. "Rental income is $7.9 billion of a total GNP of $5,234 billion, or 1.5 percent." Table 7-5, p. 137. Baumol and Blinder's *Economics: Principles and Policy, Fifth Edition*. Harcourt Brace, 1991. "Rental Income was 4.7 billion, or 0.079% of GDP in 1992." Table 22.3, p. 559. Karl Case and Ray Fair, *Economics, Third Edition*. Prentice Hall, 1994. "Rent is 1% of U.S. economy in 2004". p. 283. Paul Krugman and Robin Wells, *Economics*. New York: Worth Publishers. See also: Todd G. Buchholz, *New Ideas from Dead Economists: An Introduction to Modern Economic Thought. Revised and Updated*, New York: Penguin Plume books, 2007, p. 86; and Gregory Clark, *A Farewell to Alms: A Brief Economic History of the World*. Princeton U. Press, 2007, p 198-199. The amount is inconsequential because our National Income and Product Accounts ignore the imputed rent of owner-occupied homes, and the rent that is continually deferred and hence discounted from capital gains. Dr. Michael Hudson estimates that 80% of capital gains is really resource rents. Michael Hudson and Kris Feder, What's Missing from the Capital Gains Debate? Real Estate and Capital Gains Taxation. Levy Institute Monograph #32 (1997).

[12] Joseph E. Stiglitz, (2012) *The Price of Inequality: How Today's Divided Society Endangers our Future*. New York: Norton Press, pp. 31-32.

[13] Ibid., p. 72, 266.

[14] Henry George, "Thou Shalt Not Steal," an Address delivered on 8 May 1887 to the Anti-Poverty Society, New York City. Henry George argued that seizing private titles to land, and by extension any elements of nature, was essentially theft, and was the moral equivalent to owning slaves. See

http://www.wealthandwant.com/HG/George_TSNS.html

[15] Arye Hillman, *Public Finance and Public Policies.* (New York: Cambridge University Press, 2003 p. 448. [16] Karl Gunnar Persson, *An Economic History of Europe: Knowledge, Institutions and Growth, 600 to the Present* (Cambridge: Cambridge University Press, 2010): 248.[17] *Principles of Political Economy*, Bk.5, Ch.2, sec.5. [18] http://www.youtube.com/watch?v=yAMRXqQXemU