CSI Summary

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The Ultimate Tax Reform: Public Revenue from Land Rent

This analysis explains why land value taxation is, as Milton Friedman once put it, the "least bad" tax. An ideal tax system respects a person's right to privacy, does not discourage work or savings, and does not induce dishonesty. While income, sales, and value-added taxes fall woefully short of this ideal, land value taxation meets each requirement. The supply of land is fixed, immobile, and inherently visible. If land value is taxed, the land will not flee, shrink, or hide. Once citizens, taxpayers, consumers, and voters understand the option of obtaining public revenue from land value or rent, then the logic of getting both greater efficiency and greater justice may prevail.

1. The U.S. tax system needs reform.

The U.S. tax system is widely perceived as too complex, too intrusive, and too demanding of workers' paychecks. Taxes today claim a greater share of the average family's budget than food, clothing, housing, and transportation combined. In 2005, the average American had to work 107 days just to pay taxes, compared to 44 days in 1930.

The "least bad" tax policy is one that does not violate a citizen's right to the fruits of his labor or his privacy; does not distort incentives to work and save; and minimizes the costs of compliance and administration. Taxes on income, sales, capital gains, and real property fail this test. Compliance with the income tax consumes 5 billion hours each year in the U.S., the equivalent of two million people working full time just to process the income tax. Sales taxes discourage production of some goods and distort consumer choices. The collection of sales and income taxes require that government collect information and invade people's privacy.

Some economists and institutes have proposed reforms to flatten and simplify the income tax, or to replace it entirely with a national sales or consumption tax or value-added tax. These would be an improvement, but if the goal is to fundamentally reform the tax system, then moving to an entirely different kind of tax—land value taxes—needs to be on the table.

2. What is land value taxation?

Land value taxation is a tax on land, not the buildings, homes, or other structures that might occupy the land. The proposal here is to replace some or even all of the revenue produced by other taxes with a tax on land value.

What makes land value taxation so different from other forms of taxation is that the supply of land is fixed, immobile, and inherently visible. If land value is taxed, the land will not flee, shrink, or hide. This means a tax on land values should be less distorting, easier to collect, and require less government invasion of people's privacy.

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Public revenue from land values is the most complete application of "supply-side" economic policy. Supply-side policy attempts to increase production and the supply of goods by decreasing costs, such as by lowering taxes and eliminating excessive regulations and barriers to trade. A complete tax shift away from taxing production to taxing land values would be the ultimate supply-side policy, since it removes the excess economic burden of taxation.

Unless you own a valuable vacant lot, land value taxation would most likely *reduce* your total tax bill, since it could abolish taxes on your earnings and spending as well as the portion of real property taxes that falls on buildings and other improvements.

3. Land value taxation compares favorably to other taxes.

Impact on production. When something is taxed, we get less of it. Income taxation discourages work, sales and value-added taxes discourage consumption, capital gains taxes discourage investment, and real property taxes discourage building and improving property. Since the supply of land is fixed, taxing it does not reduce its supply. Consequently, land value taxation is pro-economic growth.

Impact on behavior. Income taxes impose administrative costs on government and compliance costs on taxpayers. Income taxes punish savings, while sales taxes punish borrowing and consuming. Tapping land value, by contrast, does not distort an individual's choice to save or borrow, consume or invest. Human action would be liberated from the disincentives currently imposed by other taxes.

Least opportunity for tyranny and evasion. Income taxes require tax audits, bank account seizures, and fear-inspiring letters from the IRS requesting information or additional payments or imposing interest and penalties. Such threats to liberty would greatly diminish, if not entirely disappear, under a land value tax. Land value taxation involves less invasion of privacy than taxing the whole property, since land value assessors do not need to enter the property to assess the new pipes, the expanded wiring, the renovated kitchen, or the new cottage in the back.

4. Land value taxation is not a new idea.

The concept of taxing land values for public finance is ancient. The Bible declares “the profit of the Earth is for all” (Ecclesiastes 5:9). Land rent financed government in England during the Middle Ages. Land value taxation was viewed favorably by classical economists, starting with Adam Smith, who wrote, “Ground-rents, and the ordinary rent of land, are, therefore, perhaps, the species of revenue which can best bear to have a particular tax imposed upon them. Ground-rents seem, in this respect, a more proper subject of particular taxation than even the ordinary rent of land.”

Thomas Jefferson believed “the Earth is given as a common stock for men to labour and live on.” In 1797, he suggested “a land tax supply the means by which the individual States were to contribute their quotas of revenue to the Federal Government.”

Contemporary economists who have recognized and supported land value taxation include Leon Walras, Knut Wicksell, Kris Feder, Mason Gaffney, C. Lowell Harris, Fred Harrison, Nicolaus Tideman, and the late William Vickrey (winner of the 1996 Nobel Prize in economics). Milton Friedman, a world-famous free-market economist, once stated, “the least bad tax is the property tax on the unimproved value of land, the Henry George argument of many, many years ago.”

5. Land value taxation works in practice.

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Many private communities implement what amounts to land value taxation as a fee or assessment. A condominium owner owns his unit and a share of the “common elements” such as building exteriors, landscaping, and recreation facilities. Similarly, guests in a hotel pay a rental for one room and receive hotel amenities such as transportation (elevators), the lobby, hallways, and swimming pool. Owners of mobile homes pay rent for sites along with services, and boat owners similarly pay for a space along with amenities.

Significant land value taxation has been adopted in several countries. Taiwan, Hong Kong, and Singapore became major commercial centers in large part because much of their public finance is based on taxing land values, or in the case of Hong Kong, from selling land leases, with low taxes on trade and commerce. Johannesburg, South Africa and Sydney, Australia have levied real estate taxes on land values only.

Some cities in Pennsylvania have had a two-rate system, where land values are taxed at a rate higher than the tax on improvements. In Arden, Delaware, all residential land is owned by a trust. It leases the land to the residents, who pay rent only on their leaseholds. The trust itself pays property taxes to the county.

6. Land value taxation would reduce the size and cost of government.

A tax on land value in the U.S. would provide about 60 percent of the entire current tax revenues of the federal, state, and local governments, allowing all other existing taxes to be abolished. The revenue would be more than adequate to finance existing government spending on everything other than transfer payments. But even if land value taxation did not yield as much revenue as all other taxes now collectively raise, this is no argument against shifting as much public revenue as possible to rent-based sources.

Land value taxation also would result in a substantial reduction in the cost of government. The administrative cost of land value taxes would be less than that of existing property taxes (which require a greater inspection of buildings and improvements), and the cost of enforcing income and sales taxes would be eliminated. By improving economic growth and allowing workers to keep all the money they earn, land value taxation would result in higher incomes, reducing the demand for government welfare programs. Decentralization, privatization, and the elimination of wasteful government programs would further reduce the amount needed to fund government.

7. Land value taxation would decentralize government.

Land value taxation would shift economic power back to state and local governments. When public finance is based on land value taxation, government revenues flow up, instead of trickling down from the federal government to the states and then to local governments.

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Real estate taxes today are assessed and collected primarily by county governments. Under a system of land value taxation, funds raised would flow up from the counties to the states, and only then to the federal government. This would create a decentralizing force, shifting or "devolving" power down to local government in accord with the principle of subsidiarity: that which can be most efficiently done by individuals or smaller jurisdictions should not be done by larger or higher-level jurisdictions. Government functions would then come under more observation and control by the voters, who can monitor and alter local governments much more easily than remote federal agencies.

Based on the January 2006 CSI Policy Study, "The Ultimate Tax Reform: Public Revenue from Land Rent," by Fred E. Foldvary. Copies are available from the Civil Society Institute for $10 each.