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The Ultimate Tax Reform: Public Revenue from Land Rent

by Fred E. Foldvary*

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.[1] In 2005, the average American had to work 107 days just to pay taxes, compared to 44 days in 1930.[2]

> If land value is taxed, the land will not flee, shrink, or hide. A tax on land value has no deadweight loss.

Tax reform proposals, not surprisingly, are popular among voters and the politicians who represent them. President George W. Bush created an advisory panel on tax reform. 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 we seek to reform taxes, we should consider all the possibilities and choose, as Milton Friedman puts it, the "least bad" tax.

Even a relatively flat income tax imposes what economists call a "deadweight loss" or "excess burden" on society. Taxes on productive activity increase the price of labor or goods beyond economic costs, and so reduce the quantity provided. This reduction in production, income, and

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investment is a misallocation of resources. Resources are wasted because they do not go to where they are most wanted. We can reduce this excess burden by reducing taxes, but changing the type of tax can also reduce this deadweight loss. Economists recognize that if we tap for public revenue a resource whose quantity is fixed, the excess burden disappears. The tax does not reduce the supply and does not increase prices.

This might seem too good to be true, but in fact, such a resource exists everywhere and is indispensable for human action. That resource is land. The supply is fixed, immobile, and inherently visible. If land value is taxed, the land will not flee, shrink, or hide. A tax on land value has no deadweight loss. If the purpose of tax reform is to reduce the extra costs imposed on the economy, a tax on land value does this far better than any tax on income or goods.

If you currently pay property taxes on a home or business, you may be shaking your head at this point. You are not eager to read about a proposal that would make your taxes even more onerous. But the proposal here is not to increase taxes but to *shift and reduce* taxation. Unless you own a valuable vacant lot, the proposal presented below would most likely *reduce* your total tax bill, since if fully implemented it abolishes taxes on your earnings and spending, and it also eliminates the portion of real property taxes that falls on buildings and other improvements.

The economist Henry George analyzed taxing land value and untaxing labor and capital in his book, *Progress and Poverty*.

The tax reform presented here is not new. It has been working to some degree in many cities and countries around the world. The idea probably obtained its greatest popularity in the U.S. in the late 1800s, when the economist Henry George analyzed taxing land value and untaxing labor and capital in his book, *Progress and Poverty.*

Many economists have since then expanded on George's writing, examining both the theory and the evidence. There is even a "Henry George Theorem," which proves that in a community with optimal population, the land rent equals the value of the community's public goods. Modern economics thus affirms George's theory in a more comprehensive and more rigorous form, although the empirical question of how much revenue could be obtained from rent would benefit from more research.

An advance on George made by Spencer Heath, Spencer MacCallum, myself, and others has been to apply the economic concept of rent-based public revenue to private communities, showing that proprietary communities such as hotels, as well as associations such as condominiums, in effect use site rentals for their revenue, with the implication that most government programs could be shifted to private communities, where the rentals would be collected by contract. Examining this application would take us away from the focus of tax reform and the analysis of land rent for government revenue, but it is useful to point out that economic actors in a competitive market use rentals to pay for public goods because that is most efficient.

The use of land value or land rent for public revenue thus has proponents today, but their voices have not been widely heard in the debate over tax reform, and there are also opponents. The purpose of this report is to give greater voice to land value taxation and to better inform those interested in tax reform about this alternative. We can best judge among options when we consider the whole range of possibilities.

Organization of this report

Part 1 of this report sketches the outline of the “least bad” tax policy: 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.

Part 2 describes how land value taxation works. Part 3 discusses historical thought on land value taxation.

The impact of land value taxation, and a comparison with other taxes, is discussed in Part 4. Part 5 discusses the actual practice of land value taxation. Part 6 shows how land value taxation would help decentralize government. Part 7 concludes.

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PART 1

In Search of the Least-Bad Tax Policy

Taxes, while ostensibly payments made for the services of government, are quite unlike payments made in the marketplace. The prominent libertarian economist Murray Rothbard was among those who emphasized taxation as a "coerced exchange,"[3] in that few would freely choose to pay taxes if not for the penalties imposed on those who refuse to do so. But taxes are also different from market prices in that the tax usually has no relation to any specific benefit. Income and spending are taxed because of "ability to pay," meaning there is a flow of funds from which money can be siphoned, to put it politely.

> Land value taxation, too, is based on the benefit principle. Rent reflects neighborhood amenities.

In contrast, user fees (truly voluntary fees, not excise taxes disguised as fees) are somewhat like market prices, as the user pays for a specific and wanted benefit, such as entrance to a park. Land value taxation, too, is based on the benefit principle and on market prices. A landowner receives *extra* land value or land rental from the government infrastructure, security, schooling, transit, fire protection, and so on. Land rent, priced by the market, reflects the neighborhood amenities.

What qualities make for the best (or least-bad) tax system? Public finance economists identify simplicity, efficiency, fairness, and revenue sufficiency as the proper objectives of tax policy.[4] In his *Wealth of Nations*,[5] Adam Smith identified equality, certainty (clear manner and quantity), convenience, and economy in collection. Transparency is also an important criterion; visible taxes are better than hidden taxes.

In *Progress and Poverty* (1879), his most important book, Henry George contended the ideal tax would most closely conform to the following conditions, similar to those of Smith:

1. That the tax bears as lightly as possible upon production, minimizing the excess burden or deadweight loss.

2. That the revenues be easily and cheaply collected, and fall as directly as may be upon the ultimate payers—so as to take from the people as little as possible in addition to what it yields the government.

3. That it be certain and visible, so as to give the least opportunity for tyranny or corruption on the part of officials, and the least temptation to lawbreaking and evasion on the part of the taxpayers.

4. That it be equitable, giving no citizen an arbitrary advantage or privilege, and in being consistent with moral principles.[6]

The two things most people want from the economy and from public revenue are efficiency and equity. As to efficiency, as the world-famous free-market economist Milton Friedman stated, “the least bad tax is the property tax on the unimproved value of land, the Henry George argument of many, many years ago.”[7] We will see how Friedman is right, why land value taxation best fits the criteria of Smith and George and modern economics.

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PART 2

“Lower Taxes to the Ground”

“Land,” in the language of economics, includes all natural resources: the three-dimensional space on the surface of the Earth (including space in and on water); material land such as minerals, water, and oil; the electromagnetic spectrum; wildlife (including wild animals and forests); and satellite orbits.

> The “economic rent” ... refers to the maximum that a tenant would bid for the use of the site.

The most important potential source of public revenue from land is real estate sites. The income from land has been called “ground rent,” “economic rent,” or just “rent.” The term “rent” here will refer to the income only from the land, excluding what is paid for the use of the improvements. The “economic rent” with respect to land refers to the maximum that a tenant would bid for the use of the site. I have called this “geo-rent” to differentiate it from “rent” as a payment for any resource or from the actual amount a tenant may pay, which could be less than what the market could bear.[8]

Land value taxation taps the geo-rent. Like today’s real property tax, a land value tax would have some tax rate that would tap some percentage of the land value or rent. I suggest 80 percent of the geo-rent be used for public revenue. The landowner would pay it from the rental he collects from the tenant, or if owner-occupied, from the implicit rental value he obtains from the site. The 80 percent rate would leave some of the land rent with the landowner to have a margin for assessment error and also to maintain a positive price for the land to facilitate its sale.

There are several methods of assessing land value or rent. One way is to calculate the replacement value of the existing improvements (unless they are historic), and then subtract the depreciation of the buildings. Then subtract the building value from the total property value. What is left is land value. For commercial property, one also can take the net income and subtract the return on the improvements (using some interest rate), the remainder being land rent. In some places there is vacant or bare land that has a market price, and sometimes there are separate owners for the land and the improvements, for which data can be derived from leases and sales. The assessors then smooth out the neighborhood land values, using computerized maps. It is not necessary to individually assess the values of most of the buildings in a neighborhood, since most lots in a locality will have a similar value per lot.

Assessors enter this data into computers, which generate neighborhood maps. The assessors interpolate or smooth out the prices of lots between those for which they have recent sales or rental data, since land values tend to be similar in a neighborhood unless there is some special feature such as corner lots or odd-sized lots.

It does not matter whether the tax is based on the land value or the land rent. I suggest basing it on the land value, similar to current real property taxes. The price of land is related to the rent by a formula, where p is the price, r the annual rent (assuming constant rents), i the real interest rate (after subtracting the inflation rate), and t the tax rate on the price (so if t = .1, the tax is 10 percent of p):

$$p = r / (i+t).$$

The fraction f of the rent taken is

$$f = t / (t+i)$$

Alternatively, given the fraction of the rent that is taxed, the tax rate on the land price p, given interest rate i, is

$$t = fi / (1-f),$$

i.e. the (fraction of rent) times (the real interest rate) divided by (one minus the fraction).

For example, suppose we want to tax 80 percent of the geo-rent, hence f=.8. Suppose the real interest rate is 5 percent, hence i=.05. Then the tax rate on land value is:

$$t = .80 * .05 / .20 = .04/.20 = 20 \text{ percent}.$$

A tax of 20 percent of land value taps 80 percent of the economic rent. Note that the land price falls as either the interest rate or the tax rate rises. The approximate ratio of the price of taxed land to non-taxed land is:

$$i / (i + t)$$

So if t is 20 percent and i is 5 percent, then the price of the taxed land would be about one-fifth of the price of the untaxed land.

The rental value of oil, minerals, and water is more complex. Government often subsidizes water, especially to agriculture, selling below cost, whereas efficient provision would base the price on the market price, often above cost, the extra amount being rent. Offshore oil leases are commonly bid on by companies, and the bids are basically the rent they pay for the leases. There can also be extraction fees that take the rent as the raw material is taken out. Such fees can be paid for taking natural resources such as timber and wildlife.

The frequencies of the electromagnetic spectrum also can be taxed as a type of natural resource. The market for the frequencies will set the rent. If an active market does not exist, then the current users can self-assess, subject to having to sell if another user wishes to buy it at that assessment plus some set premium.

Some may wonder why anyone would own land if most of the rent is taxed away. One would own land for the same reason people rent land: in order to use it. Ownership also gives the title holder rights of possession, the ability to control the use of the site indefinitely.

Today there is also a speculative motive for owning land, to profit from the increase in its price. With most of the geo-rent tapped for public revenue, the speculative motive would be dampened. That would benefit the economy, since with a lower price of land, funds that now go to buy land would instead go to build more capital goods, hire more labor, or provide better training.

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The tax on the geo-rent would be borne by the owner, not the tenant. If a landlord, who was already charging what the market could bear, tried to pass on the tax, he would face vacancies. Some say that since the tax would be invisible to renters, the link between using public services and paying for them would be broken. But productive public services increase the geo-rent, so that link is there. If government revenue is wasted, then indeed this does not generate rent, and a land value tax without corresponding benefits would reduce land value. Pressure for a productive use of public revenue would come from the landowners more than from the tenants. But that is no different than the situation today; poor folks pay little or no income tax and no property tax, and typically they get government assistance. This is an argument not against the use of rent, but in favor of privatizing government programs. In the private sector, the link between ownership and control is stronger.

PART 3

Economic Thought on Land Value Taxation

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.[9] During the 1700s, some French economists proposed an "impöt unique" or single tax on land value. Calling their theory "physiocracy" (the rule of natural law), they outlined a model of economic development that used land value taxes to finance public works, which increased the value of the land (and thus increased taxes paid to the treasury), resulting in an upward spiral of development and prosperity. The principal physiocratic economist, François Quesnay, wrote

> *Taxes ... should be laid directly on the net product of landed property*, and not on men's wages, or on produce, where they would increase the cost of collection, operate to the detriment of trade, and destroy every year a portion of the nation's wealth. [Emphasis in the original.][10]

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John Locke, the natural-law philosopher whose thought is reflected in the Declaration of Independence and Bill of Rights, wrote, "the things of nature are given in common"[11] and "no man could ever have a just power over the life of another by right of property in land ..."[12] Locke recognized the benefits of private ownership of land and the right of individuals to possess land—a right he contended came about when an individual mixed his labor with the land. But Locke, in his famous "proviso," stipulated that such private ownership would be held on the condition "where there is enough and as good left in common for others."[13] Though Locke did not explicitly state how that condition could be met, the payment to a community of the rent, which measures the extra productivity of superior relative to inferior land, would seem to satisfy the condition, since this would keep in common the benefits of holding the better lands.

Land value taxation was viewed favorably by the 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."[14]

In the late 1700s, Thomas Spence proposed communities made up of leaseholds, thus financing community expenses from the rent, an idea advanced later by Ebenezer Howard, who influenced the design of residential associations in the twentieth century.

Land value taxation and the founding fathers

Thomas Jefferson believed "the Earth is given as a common stock for men to labour and live on."[15] 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."[16]

From 1778 to the adoption of the U.S. Constitution in 1789, the United States was governed by the Articles of Confederation. Article VII stated the expenses of the Confederation

> shall be defrayed out of a common treasury, which shall be supplied by the several states, in proportion to the value of all land within each state, granted to or surveyed for any person, as such land and the buildings and improvements thereon shall be estimated according to such mode as the United States in Congress assembled, shall from time to time direct and appoint. The taxes for paying that proportion shall be laid and levied by the authority and direction of the legislatures of the several states within the time agreed upon by the United States in Congress assembled.[17]

Thus, the states would levy taxes and each would pass on a share of the federal budget based on its land value. Individuals would pay taxes only to their state and local governments.[18]

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Thomas Paine, the eighteenth century political philosopher and activist known for his important role in the American Revolution, advocated in *Agrarian Justice* that land rent is the proper source of public revenue.[19] Paine wrote, "it is the value of the improvements only, and not the Earth itself, that is individual property. Every proprietor, therefore, of cultivated land owes to the community a ground-rent, for I know no better term to express the idea by, for the land which he holds ..."[20]

An idea widely held, yet little known!

Land value taxation is often ignored in policy discussions. For example, the publication *Towards Fundamental Tax Reform*, analyzing various proposals to reform the U.S. tax system, discusses taxes on income, sales, and value added. The editors recognize "Government should seek to raise sufficient funds to finance the desired level of spending in a manner that does the least amount of damage possible, while distributing the tax burden equitably."[21] Yet the book has no mention of taxes on land value or rent, even though, as argued in this study, land value taxation best fits those criteria and resolves the alleged trade-off between efficiency and equity.

Nevertheless, many economists have recognized and supported land value taxation for public finance. Léon Walras, known for his development of general-equilibrium theory, wrote land rent provides the best means for funding a state.[22] Knut Wicksell, a Swedish economist who integrated classical, neoclassical, and Austrian economic thought, wrote, "the general economic development of the community" increased the value of its land, and he proposed taxing such increases.[23] Contemporary economists who have written favorably about land value taxation include Kris Feder, Mason Gaffney, C. Lowell Harris, Fred Harrison, Nicolaus Tideman, the late William Vickrey (winner of the 1996 Nobel Prize in economics), and myself.

Other economists have opposed the public collection of rent. William Fischel (1998) accuses land value taxation of high administrative costs in "the knife-edge goal" of "getting almost all land rent." He does not say why there has to be such an impossible "knife-edge goal." Others claim the administrative costs of property taxes are greater than for income taxes. But even if this is so, real property taxes already exist, so eliminating income and sales taxes can only reduce total tax-collecting costs, not increase them.

Some economists agree taxing rent is efficient, but they claim the amount of revenue would be trivial. Salvatore and Diulio (1996), for example, have an exercise in their textbook: "What are the criticisms of the single-tax movement?" This was the movement for a single tax on land value, by the followers of Henry George. One criticism offered in that book is the assertion, provided with no evidence or citation, that "rents in the United States today amount to just about 1% of GNP," ignoring the fact that the U.S. housing stock alone amounts to $15 trillion[24] and research that indicates geo-rent is about 20 percent of GDP.

There will always be critics who concoct a huge cost in getting assessments correct down to the last penny, or claim, without any evidence, that real estate is a trivial portion of the economy. Such critics date back to the days of Henry George, when the landed interests felt threatened by his ideas. Those opponents have been thoroughly rebutted in the book, *Critics of Henry George* (the latest edition edited in 2004 by Robert Andelson). The reasons for such attempts to falsify and trivialize rent-based public finance, and even to eliminate the land factor from economics, are chronicled and analyzed in *The Corruption of Economics*, especially in the chapter by Mason Gaffney, "Neo-classical Economics as a Stratagem against Henry George." This negative viewpoint is perpetuated by academics who learn of land value taxation from misleading secondary sources, not bothering to dig any further.

Several prominent libertarians have recognized land value or rent as the source of public finance most compatible with liberty.

Those who argue it is impossible to assess the value of land apart from improvements need to answer why this is in practice accomplished well in Arden, Delaware, a community established by Georgists in 1900 explicitly to demonstrate its practicality. They also need to explain how cities such as Sidney, Australia have a real property tax only on the land value, and how Japan, Taiwan, Denmark, and many other countries had successful land taxes (see Andelson, Robert V., ed., *Land-Value Taxation Around the World).* Also, thousands of condominiums assess their owners independently of their personal property. If this is said to be impossible in theory, yet it is done in common practice, one wonders about a scholar who ignores the widespread practice in favor of the alleged doctrine.

Several prominent libertarians have recognized land value or rent as the source of public finance most compatible with liberty. Albert Jay Nock, for example, distinguished between the improper political means of obtaining wealth, such as from arbitrary taxation, and the proper economic means, from enterprise. He regarded public revenue from land rent as within the economic means, since the “monopoly of economic rent, on the other hand, gives exclusive rights to values accruing from the desire of other persons to possess that property; values which take their rise irrespective of any exercise of the economic means on the part of the holder.”[25] (He used the term “monopoly” in its classical meaning, in which a new entrant cannot increase the supply, hence together, the landowners have a monopoly.)

Chodorov regarded a tax on land value as not a true tax but a “payment for the use of a location, determined by the higgling and haggling of the market.”

Frank Chodorov, a fervent individualist and founding editor of *The Freeman*, published by the Foundation for Economic Education and still a leading libertarian journal of ideas, became in 1937 director of the Henry George School of Social Science in New York City, serving until 1942. Like most followers of Henry George, Chodorov regarded a charge on land value as not a true tax, which arbitrarily extracts wealth, but a “payment for the use of a location, determined by the higgling and haggling of the market, and it makes no difference to the land user whether he pays rent to the city fathers or to a private owner.”[26] Explaining the value of a location derives to a great extent from community services, rather than the efforts of the landowner as such, Chodorov noted “it would seem logical that this value—which we call land rent—should go to defray the expenses of these common services.”[27]

Friedrich Hayek was ambivalent about using rent for public finance. Hayek was first inspired to study economics after being exposed to Georgist ideas. He thought using rent for public finances is a good idea if the land value could be separated from the value of the improvements, which in practice can be and is done by professional assessors and appraisers, as discussed above.[28] Hayek regarded any tax as inherently socialist, but he regarded a tax on rent as the least-bad “socialist” tax.

The libertarian thinker Murray Rothbard thought it was impossible to tax rent, since doing so would drive land prices to zero, also eradicating rent. But that proposition would apply equally to private rent collection by landlords of mobile homes, who would by that logic be unable to collect rent. Rent in fact does not get reduced when taxed. (See the book *Critics of Henry George* (ed. Robert Andelson) for an analysis of how Murray Rothbard, Spencer Heath, Friedrich Hayek, Ludwig von Mises, and other libertarians viewed and criticized public revenue from land rent.) My suggestion to tap 80 percent of the rent would avoid the Rothbard criticism. Even Henry George proposed the owner keep some of the rent. The accusation that land value must drop to zero is not an argument against taxing some or even most of the geo-rent.

PART 4

A Comparative Analysis of Land Value Taxation

We now analyze the criteria for taxation, discussed above, to see how tapping geo-rent for public revenue compares with taxing income, value added, consumption, and sales.

Impact on production

It is widely understood that when something is taxed, we get less of it. As discussed above, this reduction in labor, production, and investment is called the "excess burden" or "deadweight loss" of taxation. 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. Those taxes make the asset or activity more costly, which then reduces the quantity bought of the thing being taxed.

What makes land different is that its supply is fixed, and it is independent of human action. When land value or rent is tapped for public revenue, the land does not shrink, flee, or hide.

When land value or rent is tapped for public revenue, the land does not shrink, flee, or hide.

Recall the definition above, that land means natural resources. Real estate sites consist of the three dimensional space within some boundary of title or jurisdiction. We cannot import land to expand the amount of space. There can be no land factories to produce more space. Chopping down trees, leveling inclined slopes, and draining and filling in water only change the material contents of the space, not the extent or location of the space. Building taller just makes more space usable; the three-dimensional space does not expand.

Some critics of this proposition claim the supply of land is not fixed, because all resources are subjective. Extreme subjectivists seem to think that if there is a boundary line between your land and my land, that is not an objective fact, since I may subjectively think the boundary line is different from what you think. The line is in the mind, not on the ground. In my judgment, such views would take us out of the realm of common-sense economics into rarified philosophical areas of metaphysics, ontology, and epistemology. Ordinary folks believe that if I draw a line in the sand, it is an objective enough fact for practical purposes, because there is an intersubjective agreement on phenomena such as boundary lines.

Some economists of the Austrian school reject the distinction between land and capital goods. They think improvements such as buildings are also land, so the supply is not fixed. But that is a semantic quibble and a refusal to face the issue. The common-sense fact is that the space in a plot of land cannot be increased or decreased. Whatever one wants to call it, we can distinguish stuff we *construct* on a site from the site itself.

Another objection is that landowners can change the boundary line and so expand the amount of land. But the “supply of land” does not refer to the size of an individual’s title, but to the total amount in some market area. If Roy buys Jane’s land that is adjacent to his, his increase in land is exactly offset by the decrease in the land she owns. The tax on the combined lot will be the same as the sum of the land taxes on the previously separate lots.

The “supply of land” does not refer to the size of an individual’s title, but to the total amount in some market area.

Another source of confusion is the claim that since the rent of land depends on demand, which is done by human beings, this makes the supply of land variable. This view confuses supply with demand. Demand is the willingness of buyers to pay. This is independent of the quantity that is available. If there are three specimens of a rare stamp, the bids of those wanting to buy it do not change the number of stamps in existence.

Another error made even by academic economists is to confuse the supply of land for a particular use, such as housing, with the overall supply of land. Of course the supply for a particular use can vary, since, for example, we can convert farmland to housing land. But the total area available for all uses does not change, and that is the relevant supply.

The relevance for taxation is that if a plot of land used for a factory is taxed, the owner will not suddenly want to convert it into a farm unless its use as a factory was suboptimal. If the plot was already being used to maximize the rent, taxing it will not change the use. Taxing the site will also not make the boundary lines move to the west. Taxing the site will also not affect the demand by tenants to use the site.

Another objection to taxing land value, which some find compelling, is that when the owner bought the land, he already paid the present value of all future rents, so taxing the land would be a double payment. But many who bought their lands in the past have enjoyed gains, often large, in the real estate value. Moreover, this is only a transition problem; once the tax is in place, a new buyer’s tax is offset by a lower price for land and lower mortgage interest payments. Such an argument would prevent the liberation of slaves, since slave owners also pay the value of future labor when they buy a slave.

Impact on behavior

Income taxes impose on the economy a large administrative cost by government and a cost to payers of filling out forms, paying lawyers and accountants, and trying to comprehend the complex requirements. The compliance cost of lost time in the U.S. is 5 billion hours per year, the equivalent of two million people working full time just to process the income tax. In dollar terms, the compliance cost is estimated to be more than $200 billion per year.[29]

Reformers who want to impose a national retail sales tax are well aware of the substantial impact taxes have on human behavior. That, indeed, is often why such reforms are proposed: The reformer wishes to discourage borrowing, reduce consumption, or encourage savings, for example. But moving to a national retail sales tax results in little improvement.

Most people use their wage income to pay for goods and services and sales taxes. Switching from an income to a sales tax is like taxing you when you leave a room instead of when you enter the room.

Income taxes punish savings, but sales taxes punish borrowing. If you borrow $10,000 to buy a car and there is a 20 percent sales tax, you need to borrow an extra $2,000 to pay the tax. Some folks might decide to not buy the car, spending the $10,000 on something else, without borrowing $2,000.

There is no good economic reason to tax-punish consumption or borrowing. The purpose of production is consumption! If we punish consumption, we punish production. Consumption is not an evil to be thwarted, but the very benefit we get from the economy. We may as well also tax fun and joy! Those seeking to tax consumption act as though they have a Puritan streak that considers enjoying goods to be evil and working and saving to be good for their own sake.

Tapping rent or land value, by contrast, avoids the manipulation of an individual’s choice to save or borrow, consume or invest. A well-constructed land value levy has no distortive effect at all on human action or decisions, since it taps a pure surplus, what is left over after paying for the economic costs of production. The effect of shifting public revenue from labor and capital to land would be to liberate human action from the disincentives currently imposed by other taxes.

There would no longer be any tax audits. There would be no record-keeping for taxes.

As Henry George noted,

> The advantages which would be gained by substituting for the numerous taxes by which the public revenues are now raised, a single tax levied upon the value of land, will appear more and more important the more they are considered ... With all the burdens removed which now oppress industry and hamper exchange, the production of wealth would go on with a rapidity undreamed of ... [It would be] like removing an immense weight from a powerful spring.[30]

Costs of collection and administration

Consider the effect of abolishing income taxes and sales taxes, replacing them with a land value tax. There would no longer be any tax audits. There would be no record-keeping for taxes. You, the landowner, would instead get a monthly bill, like you get for utilities. You would simply pay the bill or have it automatically deducted from some financial account. At the same time, government would avoid the high cost of processing complex accounts and keeping individual tax records. It would only need to keep real estate records and assess the land values, both of which it already does for property tax purposes.

Those who are retired or temporarily have little cash income would be able to defer taxes by accumulating liens on the real estate until they die or sell the property, as is commonly done today with real estate taxes.

If you thought the assessment of the land value was too high, you could appeal, as one can today's real estate taxes. The land value assessments would be public records available on the Internet, unlike income tax records, which are quite properly hidden from public view. You could easily compare your assessment with those of your neighbors. If the appeals board rejected your claim, the assessment could be appealed to a jury, if you were willing to pay the cost of the jury's decision.

Land value taxation also involves less invasion of privacy than taxing the whole property, since land value assessors do not need to enter the property to assess it. They don't assess the new pipes, the expanded wiring, the renovated kitchen, or the new cottage in the back.

Nobody would be sent to prison for tax evasion, because there would be no tax evasion. A non-payer would lose title to his land or lose the protective services of government, depending on the local enforcement practice. Property taxes are already being assessed and collected by counties in the U.S. A complete shift to the taxation of land values would not increase these costs, but would eliminate the expenses involved in collecting sales and income taxes.

Least opportunity for tyranny and evasion

Without audits, bank account seizures, and fear-inspiring letters from the IRS requesting information or additional payments or imposing interest and penalties, the opportunity for tyranny would greatly diminish, if not entirely disappear. Evasion being impossible, there would be no need or excuse for any inquisitive state investigators of fraud. Land value taxation also involves less invasion of privacy than taxing the whole property, since land value assessors do not need to enter the property to assess it. They don't assess the new pipes, the expanded wiring, the renovated kitchen, or the new cottage in the back.

Justice, fairness, equity

We still need to judge whether it is fair for only landowners to pay the taxes, rather than to spread the burden on all who get income or spend money or have wealth.

Natural-law philosophers such as John Locke have reasoned that all human beings have a natural ownership right to their labor and the products of that labor. The fundamental equality of humanity means it is fundamentally wrong for some to take away the labor done by others.[31] That notion is almost universally recognized today with respect to slavery, and some folks are beginning to recognize that the current tax system—which taxes our earnings and taxes how we invest or spend those earnings—also violates man's natural right to the fruits of his labor.

If taking the fruit of one's labor is fundamentally unjust, how can a community raise the monies needed to build essential infrastructure and provide public services? Land value taxation takes into account not only the value of the land due to nature, such as soil and climate, but also the great increase in land values that result from population, commerce, security and other civic services, and public works—elements beyond the activity of the property owner. The windfall increase in the rental or land value of the land, contended Henry George and others, is a surplus that can be tapped by the community.[32]

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Those suggesting positive consequences of shifting taxation to rent have been accused of exaggerating its beneficial effects.[33] Freedom from punitive taxation is not a panacea, but the infliction of arbitrary costs on enterprise and the skewing of market signals such as prices and profits is indeed a universal and major cause of economic woes. It is not an exaggeration to propose that removing these would have many beneficial results, just as one's health improves considerably if one stops taking poison.

PART 5

Land Value Taxation in Theory and Practice

Land value taxation in history

Significant land value taxation was adopted in several countries. In Japan, after a revolution in the 1860s, the government transferred agricultural lands to farmers, who then paid a tax on its value. The Japanese government used this tax to finance public works and education, which further increased land values and thus the proceeds from the land value tax. This created a powerful upward spiral that turned Japan into a major industrial power. (Japan later switched to taxing income due to political pressure from landowners.)[34]

Hong Kong and Singapore became major commercial centers in large part because much of their public finance is based on taxing land values, rather than taxing trade and commerce.

The German colony of Kiaochow, China, established in 1898, had a single tax on land value set at 6 percent.[35] Its principal city, Tsing-tao, developed into a fine modern city. The Germans lost the colony in 1914 at the outbreak of World War I, but their experience influenced the Chinese revolutionary Sun Yat-sen, who became head of the government of China. He and his successors in the Nationalist Party were not able to implement land value taxation in that country, but when they moved to Taiwan in 1950 after the communists took the mainland, Chiang-kai shek implemented a land-to-the-tiller reform accompanied by a tax on land value. Taiwan has since developed into a major industrial power. 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.

Of course there are many reasons for the success of economies such as Hong Kong's, but the evidence is that more economic freedom is widely associated with greater growth and per-capita income, in accord with the economic theory that the deadweight loss caused by restricting and taxing production leads to lower production.

Many cities worldwide, including 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.[36]

Followers of Henry George established several model communities. In one of them, 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. Arden has prospered as a community with fine houses and lively community activities.[37]

Many private communities implement the single tax on land in effect, collected as a fee or assessment. A condominium owner, for example, owns his unit and a share of the "common elements" such as building exteriors, landscaping, and recreation facilities. The unit owner pays an assessment often calculated as a "percentage interest," based on the market value of the unit relative to other units. In effect, the unit owner is paying rent for use of the common elements.[38]

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. All are examples of paying rent for the use of private community services and location amenities.[39] In the private sector, rent is viewed as an efficient form of financing community services, while governments tend instead to levy taxes on sales or income or wealth, with little or no direct relationship to services.

How much revenue?

Total land values or land rents are not reported in national statistics. The U.S. national income accounts have a number only for the "rental income of persons," which excludes rent obtained by corporations and the rental value of government land. This "rental income" is after all expenses, including property taxes, and so includes only a tiny fraction of the geo-rent.[40]

> Land value taxation would result in a substantial reduction in the cost of government.

The national rent in the United Kingdom has been estimated at 22 percent of national income, which exceeds the amount raised in that country by the income tax.[41] Steven Cord[42] estimated the annual economic rent of land in the U.S. in 1986 at $680 billion, 20 percent of national income, while Mike Miles (1990) arrived at a similar figure using data from the Bureau of Economic Analysis.[43] The totals include government lands but do not include the increase in geo-rent that would occur with the elimination of market-hampering taxes. Making up about one-fifth of national income, land value taxation would provide about 60 percent of current U.S. federal, state, and local government revenue, which would be more than adequate for government spending if it did not include transfer payments.

The taxable value of the land in the economy would increase over time for two reasons. First, a shift from taxing production to taxing land values would eliminate the lost output due to taxes—about $1 trillion per year.[44] One-fifth of that would be rent, thus increasing rent by $300 billion. Secondly, the economy would grow faster, which also would increase rent over time.

Tideman et al. (2002, 17) "estimate that the net gain (measured in real dollars of 2000), from shifting as much taxation to land as could be financed by collecting 90% of the land rent, would be $1308 billion or 14% of NDP in 2002 and $4,799 billion or 26.6% of NDP in 2042."

Even if only a fraction of government revenue shifted from the types of taxes we know today to a geo-rent tax, the efficiency gains could be substantial. Some critics simply do not believe these results, without bothering to read them. I have not seen a rebuttal of Tideman's calculation.

Even if land value taxation does not yield the revenue that is desired, this is no argument against shifting as much public revenue as possible to rent-based sources. 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, is the ultimate supply-side policy, since it removes the excess economic burden of taxation. The public collection of land rent is thus the ultimate in tax reform.

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Land value taxation would also 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.

How to make the transition

The switch to land value taxation will affect most significantly those who own land at the time of the transition. These are the persons who have been subsidized, receiving site rental and land value from civic works paid for mostly by taxes on wages when earned or spent. But even many landowners would not see their total tax burden rise. Their wages, profits, interest, and consumption would all become untaxed, and taxes on their buildings and other improvements would be eliminated.

As shown by the equations earlier in this report, the land value tax is not even any burden on future owners of the land, since the tax on the land reduces its purchase price. What the owner pays in a tax on his geo-rent, he saves in not having to pay that amount as mortgage interest.

There are two ways of addressing any net burden that might fall on current landowners during a shift to land value taxes. First, landowners could be compensated. Second, the shift could be implemented gradually, allowing land values to fall to accommodate the expected and gradually implemented tax shift.

As a concrete example, the transition to land value taxation can be accomplished in these steps:

1. Each county expands its register of all real estate and the title holders to include all lands owned by governments and previously non-registered entities.

2. Local real estate taxes are split into two taxes, one on land value and one on improvements.

3. The county real estate assessment function is transferred to land value assessment boards, comprised of representatives from the federal, state, county, and municipal governments as well as real estate professionals and scholars. These boards appoint assessors and establish an appeals process, similar to current real estate tax appeals.

4. All land is assessed at its current market value.

5. Over a period of years, depending on how much land values already have fallen in anticipation of the tax shift, the tax on improvements is reduced, while the tax on land values is increased. (An immediate tax shift to geo-rent, with other taxes reduced or abolished, could be compensated, for those with net losses, with special bonds whose face-value interest payments would decrease over time; this would have an effect similar to the gradual increase in the geo-rent tax rate.)

Over a period of years ... the tax on improvements is reduced, while the tax on land values is increased.

6. Sales taxes, tariffs, and excise taxes are reduced and eventually eliminated.

7. The personal exemption in federal income taxes is raised each year, until it eventually includes all income, at which time all state and federal personal income taxes are abolished. The taxation of corporate profits is also phased out.

8. The value of material land (minerals, oil, water, etc.), the electromagnetic spectrum, naturally growing forests, and other natural resources is taxed at gradually increasing rates up to a substantial amount, if not all, of the unimproved rental value.

9. An amendment to the Constitution is enacted prohibiting any taxation of wages, sales, profits, value-added, or produced wealth and establishing the taxation of the value of land and other natural resources, along with voluntary user fees and charges for pollution and congestion, as the only sources of public revenues. The amendment also establishes a land value tax commission with representatives from the federal, state, local, territorial, and Indian-nation governments to divide the taxes raised. Generally, taxes raised from off-shore oil and water, atmospheric pollution, airline routes, and other continental uses would be allocated to the federal government, and the rest would be allocated to the state (or provincial, in Canada), local, territorial, and Indian-nation governments. If the national government needs additional revenue, it is obtained from the state or territorial governments in proportion to their land value, as was specified in the Articles of Confederation that preceded the U.S. Constitution.

10. Top-down revenue sharing from federal to state and from state to local government stops. Many services, functions, and agencies are transferred from the central government to the state/provincial and local governments.

Critics of land value taxation claim that over time, there would be popular pressure to bring back the income and sales taxes. It is true that those owning valuable commercial land will always seek to lower the tax on land and shift taxes to labor and capital. It is also true that governments can ignore constitutional rules, and governments get overthrown. By this argument, the slaves should never have been freed, because slavery can always be restored. Women should not have been given the opportunity to vote, because that could be reversed. This is an argument against any reform and indeed against any action to improve your condition. (Why bother to work? You might lose your money, and it will have been for nothing.) This is ultimately a philosophical argument for the futility of any human action.

But the fact is that there was a shift in public attitude about slavery, and most folks now believe it was morally wrong. It would be politically difficult today to reverse the equal rights of women to vote. Similarly, once there is a shift in public attitudes about taxing wages, the view that it is morally wrong to tax labor could be just as irreversible.

Once there is a shift in public attitudes about taxing wages, the view that it is morally wrong to tax labor could be just as irreversible.

PART 6

Land Value Taxation and Decentralized Governance

The United States is a federation of states (and Indian-nation reservations), with many government functions such as criminal law, education, and local services provided by the states. Since the federal income tax was enacted in 1913, taxation and authority have shifted increasingly to the federal government.

In 1902, federal taxes represented 37 percent of total revenue to governments at all levels.[45] By 2002, federal taxes represented 67 percent of the government revenue pie.[46] The share taken by state governments rose from 11.4 percent in 1902 to 21.5 percent in 1986. Local governments' share fell from 51.3 percent in 1902 to 13.7 percent in 1986.

> Land value taxation would shift economic power back to state and local governments.

The change in the share of tax revenues taken by each level of government has occurred in large part because of the relative ease of increasing income taxes at the federal level, and the relative difficulty of increasing local and state taxes. Taxpayers find it much easier to respond to changes in state and local taxes, by moving to lower-tax communities. It is far more difficult to avoid taxes imposed by the federal government—especially since U.S. citizens are taxed even if they are abroad.

Revenue-sharing from the federal government to the states is, in effect, a tax cartel among the states, collusion to tax the population and then divide the funds among the states. Taxation at the federal level also encourages spending by the federal government instead of the states, so now we have federal departments and agencies for education, housing, health and welfare, energy, and other fields that once were local, state, or private-sector matters.

Local and state governments, once willing to go along with the federal government's tax-and-revenue-sharing scheme, are beginning to realize centralized taxing brings with it centralized authority, dramatically reducing local control. Revenue-sharing comes with strings attached: Local and state governments must abide by federal government mandates in order to obtain the funds, taken from their residents in the first place. Revenue-sharing allows the federal government to sidestep the Tenth Amendment to the Constitution, which provides that powers not specifically delegated to the federal government are reserved to the people and the states.

Land value taxation would shift economic power back to state and local governments. Land is suited to local taxation because—unlike enterprise, capital, and labor—it cannot be moved. Land is also the logical source of local public finance because it does not burden enterprise, so that entrepreneurs don't even *want* to run from it. Indeed, entrepreneurs welcome a shift to land value taxation, not only because their economic profits are not taxed if all taxation is on land values, but also because land value taxation reduces the price of land, so they do not need to borrow so much when they invest funds in an enterprise.

> 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.

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. 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.

Land value taxation 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.

PART 7

Summary and Concluding Remarks

An ideal public revenue policy 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.

An ideal public revenue policy respects a person's right to privacy, does not discourage work or savings, and does not induce dishonesty.

Imagine the increased prosperity and opportunities for advancement that would exist if people could keep all of the money they earn; if billions of dollars wasted on efforts to avoid high income taxes were suddenly turned to productive endeavors; and if the growth of government were constrained by a tax system that would raise only enough to pay for services actually provided.

Land value taxation is central to the political philosophy of the founding fathers of the United States. Far from being a new idea, or the idea of a small group of thinkers, it is a concept embraced by many of the most important figures from our history: John Locke, Adam Smith, Thomas Paine, Thomas Jefferson, and today, Milton Friedman. Land value taxation is part of America's proud and distinguished tradition of political philosophy. Surely it belongs in the national debate over how best to reform the nation's tax system.

The shift from taxing productive human action to collecting the economic rent generated by nature and communities is more than a fiscal reform. There is a philosophical and even spiritual side to this reform.

One of the ongoing problems of social philosophy is the relationship of the individual to society. In conventional tax policy, there is an inherent conflict between the individual and government as the agent of society. Individuals want to benefit from the collective services provided by government, but the mechanisms for financing those services typically have used force against individuals and invaded their private lives.

The collection of land rent for public revenue reconciles the individual and the community. The community and its government no longer intrude into the individual's private life and stifle his or her pursuit of economic well being. The tax on land value is not a tax in substance, but only in the form of payments to government. In substance, the payment is a sharing of the benefits provided by community and nature, and a payment for the services that generate the value of the land. If this payment is not made by the landholder, the services become a subsidy, producing a value not returned to the community.

The public collection of land rent can induce an efficient use of land. Land value taxation gives land a "carrying cost," inducing title holders to put their land to its most productive current use, rather than hold it awaiting higher prices. With the price of land thus kept low, banks would lend for productive investments rather than to buy land.

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 well prevail.

Public revenue from land rent is a necessary element of true free trade and a genuinely free market. Even a small and flat income tax, sales tax, or tariff grants government the power to intrude into transactions, adding friction that reduces the flexibility of an economy. The elimination of this friction and deadweight loss is made possible by land value taxation.

The obstacles to land value taxation are political. The current system benefits certain vested interests that will resist reform. But since the public at large will benefit from a shift to land value taxation, and since they greatly outnumber those obtaining privileges from the current system, the greater reason why this tax reform has not taken place is that the public has not been informed. 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 well prevail.

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