PROGRESS AND POVERTY (at substack)

THE COMMONWEALTH CITY

By Joseph Addington / 14 November, 2022

My last post contained a bold conjecture: that many of the most pressing problems facing cities today are ultimately the result of a zero-sum battle over urban land values.

As if that wasn't bold enough, I further conjectured that this is a problem that cannot be solved by policy because at its core it is not a policy problem. It is a problem with the way we treat the very thing our cities are built on: land.

This means that the best approach to solving these problems is not by rallying for policy reform, but by inventing a better system that corrects the flaws in the current system.

The essential problem with land value today is that people living in cities generate enormous wealth, but only people with enough capital to buy or good fortune to inherit land benefit from that value creation.

Urban land values are publicly created but privately captured.

This has been such an under-the-radar issue because this process is largely invisible. It doesn't *feel* like we're having the value we create taken from us when we live and work in a city, but that's indeed what happens.

It is true that if a person can save enough for a down payment and mortgage on a condo or home then they can become a landowner too. But this is just switching sides in the fight, not figuring out a way to stop fighting.

The Commonwealth City

There's a better way, and I call it the Commonwealth City.

Last issue I argued that the invention of the corporation was a big deal because it unlocked a new form of positive-sum cooperation for humans.

Today I want to argue that the way to solve our zero-sum land value problem is through a similar structure. The Commonwealth City simply applies some of this same thinking to land.

From last issue:

> *A big part of the magic of the corporation is bundling all assets, liabilities, and the right to future cash flows into a single “thing” called a corporation, and then letting individuals own pieces of that rather than pieces of the individual assets, liabilities, and cash flows.*
>
> *This **one weird little trick**™ of abstraction makes incentive alignment possible on a previously unimaginable scale. Not only does it mean thousands of people can work together towards a common goal, but that they do so voluntarily!*

The Commonwealth City functions similarly: All land and its associated future cash flows are bundled together into one “thing” called a Commonwealth City.

The individual then buys one or more ownership claims (let’s call them shares, just like a company). Ownership of those shares entitles you to a proportional slice of everything the Commonwealth City owns today (all the land within the city) and to a proportion of all future ground rents it collects.

Instead of owning a particular piece of land in a particular place, residents own a piece of the entire city.

This subtle change turns urban land value from a zero-sum game to a positive-sum game. It aligns the interests of current and future residents by creating a direct financial incentive to maximize the value of the city as a whole rather than maximize the value of any individual piece of land.

“This all sounds pretty straightforward so far. But Joel, if people don’t own particular pieces of land anymore, how do you get stuff built on top of the land?”

Great question.

How does stuff get built?

Use of land in the city is allocated through a system of long term ground leases. The city leases land to anyone who would like to build something. This can be developers, homebuilders, individual homeowners, companies wanting to build an office, etc.

The lessee makes annual lease payments for the exclusive right to build on a **particular** piece of ground. These lease payments to the Commonwealth City compensate all other residents of the city for being excluded from using this particular piece of land.

This is at the heart of how we return publicly created land value to the community. That piece of land that the developer wants to build on has value only because of the presence of the community around it. Land can still be privately and exclusively used and built on like today, the difference is that the lease payments directly compensate the community for the value they've created, rather than that value being taken by whoever happens to own the land.

“But Joel,” you protest, “Developers have it so good under the current system, why would they want to build under a system like this?”

I'm glad you asked. A system like this would actually be better for developers than the present system in two main ways:

First, there is no upfront land cost. Land can sometimes be up to 20% of a development project's total budget. That's a lot of money on a $100M project!

Why the high values? Because in order to trade land, we have to take all the future ground rents it will produce, discount them back to the present and capitalize them into a single value. That means you pay up front for all value the land will generate from the day you buy it until the end of time.

This introduces a lot of uncertainty. If conditions change and something causes the future value of those ground rents to fall, you could be underwater on your mortgage (you could owe more to the bank than the project is worth). This is not good.

In the Commonwealth system, we treat ground rents the way they ought to be treated: **as a continuous rather than discrete function.** Only pay for what you use.

The happy advantage of this is a developer doesn’t have to outlay (and finance with borrowed money) millions of dollars just for the land purchase on the front end.

In an actual implementation of this, early ground leases would be subsidized for the first developers to build there.[1]

The second advantage for developers derives from the fact that to implement the Commonwealth City model means you have to build the city from the ground up. This allows you to invent a better building entitlement process.

This would allow the city to offer approvals to developers up to 100 times faster than today by maintaining a library of pre-approved building types, and/or granting trusted developers automatic approval.

Further, because it would lower the barrier to development (both upfront land cost and the regulatory burden) it would allow more people to become developers. Anyone with the ability to get a small construction loan could lease land, select a pre-approved building type and hire a construction company to build modest multi-unit buildings to provide housing for themselves and others.

And don’t worry: using a library of pre-approved building types wouldn’t make the city look the same. It is possible to vary the architectural detail on just a handful of building types and create incredible diversity.[2] Consider the row-houses of Amsterdam. These all have the same basic dimensions and building core, but the facades are architecturally very distinct:

Photo by Rifad Lafir on Unsplash

Follow the Money

Okay so now we've established that the land belongs to the community as a whole and developers want to build there. Now we need to see what happens after the value is given back to the community.

The important thing to note about this system is that it does not eliminate increases in land value. We don't want to eliminate those, we definitely want land to become more valuable!

The innovation here is how those increases in land value are distributed. In this system, all land value increases are shared with the community in one way or another. The money collected as ground rent is either:

1. Distributed directly back to residents as a Universal Basic Income
2. Invested in new public goods for city residents - parks, infrastructure, transit, etc.
3. Invested in growth by either acquiring more land or paying to acquire new residents[3]

Finance people reading this might recognize these as analogous to the capital allocation decisions that a company faces with its free cash flow:

1. Universal basic income is like a dividend to shareholders
2. Public goods investment is like a company investing in new equipment or machinery that improves operations - capital expenditure
3. Growth is like a company investing in growth: spending money to acquire new customers, new businesses, etc.

How these allocation decisions get made is a fascinating topic that I will cover in a future issue on governance. For now, just know that a model like this would likely see a dramatic improvement in the quality of public good investment because all residents and city managers face direct upside/downside for good/bad allocation decisions.[4]

What Problems Does This Solve?

So let's say I've sold you that this model is workable. Why would we consider experimenting with it? Does it really offer enough in the way of benefits to be worth trying? After all, the only thing that really matters is that it can improve peoples' lives in some meaningful way.

Some readers will recognize this as a form of Georgism - it is the idea of "land value should be held in common by all people". See here for more on this topic.

The difference from vanilla Georgism is that the Commonwealth City is implemented using entrepreneurial rather than political means.

Because it's essentially the same idea, it has many of the same benefits that a Land Value Tax (Georgism's main feature) would have. Here are a few of the most important.

Create Perpetual City-Wide YIMBYism

Last week I outlined how one driver of NIMBY behavior is the underlying structure of land value. YIMBYs want affordability, NIMBYs want increases in home/land value (the opposite of affordability).

More housing for new residents = less land value (in the short to medium term) for existing owners.

More land value for existing owners = less affordability/housing supply for new residents.

Under the current system it is impossible for both sides to win.

And when you add on the fact that those existing landowners usually finance their ownership of real estate with big mortgages it just pours fuel on the fire. A drop in land values (housing becomes more affordable) would spell financial ruin for many of them. So the fact people oppose anything that might threaten their property value under this system is not at all surprising to me.

A lot of this effect comes from the fact that today, housing as a place to live and land as an investment are bundled together into one thing. You buy a house and the land underneath it.

This is problematic because the two are fundamentally opposed: when we consume things like housing, clothing or food we prefer they be less expensive, whereas when we invest in things we prefer they become more valuable or expensive over time.

We buy houses to live in, and we expect the land underneath the house to increase in value.[5]

When ownership of the city's land (an investment) is unbundled from any particular piece of housing (A consumer good), the incentives change. Since I own a piece of the overall city, the most straightforward way for me to increase my wealth is to get as much housing built as possible.[6]

Under the Commonwealth City model we still have ownership, we still have private property (buildings) and the incentive to innovate, we just eliminate the zero-sum fight for **my particular piece** of land to be worth more through this neat trick of unbundling land from housing and re-bundling it into the idea/legal construct of a Commonwealth City.

I live in (and can own) a house that provides me with shelter. Separately I own a piece of the overall urban land value through my Commonwealth shares. For every new resident who moves in, the land in the city becomes slightly more valuable, and my shares increase in value. This is how it creates perpetual city-wide YIMBYism. Not with policy, but with incentives: what is good for the individual is aligned with what is good for the city as a whole.

Ends Wage Slavery

If you live in a big city you might feel like no matter how much you work, it's difficult to get ahead. This is not just in your head. It is because under the land value model today, any improvements in productive capacity of individuals can be captured by landowners in the city.

This might work okay if you own a little bit of land yourself (even if only through fractional ownership like a condo) but if you don't, you will have the experience of having to run faster and faster to stay in the same place.

Again, the problem is not the fact that land increases in value, but who captures that value. If you live in a city and do not own property there, you are being robbed on a daily basis.

Why? Because your very presence there makes land in the city more valuable, but the only people who benefit from that value are landowners - not you. As you make their land more valuable for them they can charge you higher rent for access to it!

Here's an extreme example of this phenomenon at work from Lars Doucet:

> *Okay, but is this [land value] still relevant in the modern age, with the internet and work-from-home? Obsessing about land just feels so 19th century. Well, in Silicon Valley rents are famously off the charts, and those and all other rents seep into the economy at every level. Workers priced out of living close by have to spend more time and money commuting longer distances to work, and businesses must devote an increasingly larger share of their production to landowners who aren't actively contributing anything to productivity. What else could explain how a family of four making $100,000 in San Francisco is considered to be living below the poverty line?*

Another more technical way to say this is that the Commonwealth City model eliminates the returns to rent-seeking behavior through land ownership while preserving the returns to wealth creation through the design and construction of new buildings on top of the land (the part that is actually valuable to people).

Creates more Landowners & Allows for Exposure Calibration

> *For that is true of pedigree which is true of property; the wrong is not in its being imposed on men, but rather in its being denied to them. Too much capitalism does not mean too many capitalists, but too few capitalists.*
>
> *-G. K. Chesterton*

The Commonwealth City model also dramatically lowers the barrier to property ownership. Today, to purchase a house in any sizable city requires an enormous amount of money, especially for those new in the workforce.

This puts most people in the unenviable situation of having nearly all of their net worth tied up in a highly-leveraged, illiquid asset, if they can afford it at all. For most people they are stuck renting: they spend their days working hard and creating urban land value, only to see that value come back to them in the form of continuously increasing rent.

In the Commonwealth City, it would be possible to own shares for less than a few thousand dollars, make additional purchases as you can, and allow that wealth to compound over time. No debt required!

If you want to go all-in on making the city the best place it can be - by moving your company there, for instance - then you can place a big bet on future increases in value.

Unless you have millions in capital to play with, you cannot calibrate your exposure with real estate today. You can own a house or not own one, but there is no real way to adjust your exposure up and down.

How is this Possible?

“But Joel, if this is such a wonderful idea, why hasn’t it been done already? Surely that means there’s some glaring flaw that renders this totally impossible.”

This is not an original idea, only an original implementation. As I mentioned above, the original idea of “Land value should belong wholly to the community that created it” was best articulated by Henry George in his 1879 book *Progress & Poverty*. George’s solution to the problem was the Land Value Tax, and he actually got close to large-scale reform.

George demonstrated that there would be no need for federal taxes on labor or capital (and the associated deadweight losses) if we simply went right to the source of all economic activity - land. This was an elegant solution, and indeed if the United States had adopted it in the late 1800’s things might have looked quite different today.

Alas, there is a lot of path dependency in the fiscal policy of nations. Once you start taxing labor and capital, it's hard to go back to taxing land. Many Founding Fathers of the United States supported land value taxation, but even at the founding of our nation it was too much to ask. Here's my man Ben Franklin bemoaning this fact:

> ***Our legislators are all landholders; and they are not yet persuaded that all taxes are finally paid by the land*** *therefore we have been forced into the mode of indirect taxes, i. e., duties on importation of goods.*

Franklin's observation is many times more relevant today. A widespread land value tax is a political impossibility through either legislative channels or popular reform. Why would tens of millions of people, many of whom have their **entire** net worth in the value of the land underneath their house, voluntarily support a policy that taxes all this value away?

Indeed, I think the answer is simply: they won't. Not in a million years. Quite the opposite in fact: they will continue to invent policy that preserves their land value.

But note what I said above: a Land Value Tax is a ***political*** impossibility. I don't think it's an entrepreneurial impossibility, not by a long shot.

An Entrepreneurial Solution

The question we face isn't "Is it feasible to implement a widespread Land Value Tax?" But rather: "Can we invent a parallel, opt-in system that accomplishes the same thing?" I think we can, and the Commonwealth City is how we do it.

The corporation enabled anyone to organize or join a positive-sum game. That game involved creating new forms of economic value by providing goods and services at scale for other members of society.

What the corporation enabled for the invention of new products and services, the Commonwealth City enables for the creation of urban land value and the provision of public goods.

The corporation allowed employees and investors who took risks and worked towards inventing those new goods and services to participate in the wealth they created.

The Commonwealth City allows residents who make the city they live in more valuable to participate in the wealth they create.

It creates a means for more people to participate in the world's largest asset class - land - while also correcting the effects caused by this messed up system of land value like unaffordable housing, urban sprawl, and waste of municipal resources.

It allows us to organize individuals towards a common goal - the increase of one bucket of urban land value - rather than fighting with each other over maximizing their tiny piece of land value.

The solution of the Commonwealth City is not perfect, just like giving people stock in a business doesn't solve all problems. It is far from utopia; it is only an improvement.

But I will die on this hill: there is no way out of America's housing mess (and the nth order effects that mess creates) without altering the underlying incentive structures around land ownership. No amount of policy change will fix that problem, and many will actually exacerbate it. We don't need reform, we need invention.

When a problem seems intractable, the solution usually involves stepping outside of whatever system you're in and inventing a new one. The Commonwealth City is my proposal for a solution to these otherwise intractable problems.

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Later, once things get going, both the lease rate and term can be market priced. I am fascinated by the use of a Harberger tax to accurately price these in a Hayekian way without the need for a big assessment operation.

The largest shortcoming of a Harberger tax is the displacement problem, but I think I have an idea of how to solve that by only using it for non-owner occupied/multifamily housing so that even in the event of an ownership change, residents are undisturbed.

2

In fact, the best way to get incredible diversity is to restrict most dimensions of design in a structure. Paradoxically, sometimes the worst thing you can do for design is say: “You can do absolutely anything you want”. This then channels all creative energy into creating a very distinct façade, rather than worrying about how wide to make the building.

3

This is still value being given back to the residents, just indirectly in the form of higher long term share value. It is actually more tax-efficient than a pure cash dividend.

4

Another way to say it is that it brings a market-based element to public goods investment. This would prevent the city from investing in infrastructure that will eventually render it insolvent (sprawl) or big vanity projects like billion-dollar stadiums or low-capacity transit lines that are done because they’re good for the politician, not for the average resident. So many municipal investments simply don’t pencil at all but this fact is obscured by the political process.

5

I’m not really sure if people realize this is what their expectation is, but it is what happens when housing increases in value. All structures depreciate - become less valuable - over time. If you buy a home and do not maintain or improve it, the structure itself will be worth less ten years from now as entropy fades the paint, wears out the mechanical equipment, and springs leaks in the roof. Yet you may still this house for a huge profit after ten years. How is that possible? The land has become more valuable, not the house. Often the increase in land value is far larger than the decrease in the house’s value.

6

There would be a robust secondary market for these shares which would make it easy to reprice them based on operating results. Just like we know if Apple sells X more iPhones that will contribute approximately Y to their bottom line, so too can the market calculate the effect of new residents into the Commonwealth City and see it reflected in the trading price. We’re still capitalizing value, but doing at the higher level of the Commonwealth City rather than at the lower level of the individual parcel.