Gavin Kerr

Gavin Kerr is an independent post-doctoral researcher. His work spans the fields of politics, philosophy, and economics.

RENT-EXTRACTION, ECONOMIC INJUSTICE, AND THE ENVIRONMENT: LAND VALUE TAXATION AS AN "ECO TAX"

The idea of ecological taxation plays an important role in the field of environmental economics, which is attracting an increasing amount of attention as the magnitude of the environmental problems facing humanity becomes ever more apparent. An ecotax, or 'green tax', is a tax imposed on environmentally harmful activities like burning fossil fuels, disposing waste, extracting minerals, and so on. The purpose of green taxes is not so much to raise funds for government expenditure - though they do of course generate a certain amount of public revenue - but rather to provide economic incentives that encourage producers and consumers to engage in less harmful economic activities. Because such taxes are generally regressive, making the less well-off even worse-off, economists and public policy experts usually recommend that they are accompanied by reductions in other taxes borne by the economically disadvantaged (such as income tax or VAT), or by benefits that offset the higher prices or lower wages resulting from the introduction of the green taxes. This is what is referred to as 'green tax-shifting'.

The idea of green tax-shifting is similar in certain respects to the idea of an economic justice tax-shift, which some progressive economists have associated with the work of Henry George. An economic justice tax-shift would consist in a systematic shift in the burden of taxation away from productive economic activity and on to the rental value of land, which George identified in the nineteenth century as the natural source of public revenue. In other words, it would require the systematic raising of taxes that bear predominantly on land rent, and the corresponding lowering of taxes that bear predominantly on wages and normal profits.

What I want to suggest is that there are a number of reasons to think that an economic justice tax-shift of this kind would also constitute a green tax-shift which would greatly enhance the environmental sustainability of a great deal of productive economic activity. Exploitative rent-extraction, I shall suggest, is not only economically unjust, but also prevents the economically productive majority from engaging in maximally efficient and therefore environmentally sustainable forms of economic activity. More importantly, it is also the main mechanism through which the rich and powerful are able to compel the rest of society to pursue more materialistic, and therefore environmentally harmful, ways of living than those they might otherwise choose to pursue. Thus, the relationship between economic and environmental exploitation is stronger and more intimate than many environmentalists and economists have typically supposed.

This is not to say that there would no longer be any need for other forms of green tax-shifting, or for environmental regulations and restrictions, or indeed for the sort of government investment and leadership that the proposed 'Green New Deal' will hopefully provide. But in my view these additional measures would be much more effective and much less urgently required against a background of economic justice than they are against the current background of economic exploitation and injustice.

EXPLOITATIVE RENT-EXTRACTION

The term 'rent' was used by the classical economists – such as Adam Smith, David Ricardo, James Mill, and John Stuart Mill - specifically in relation to the economic return to land. The classical economists recognized that since the total quantity of land is completely fixed or 'inelastic', the whole of the price paid for any given site exceeds its cost of production, which by definition is zero . Although it can be enhanced, improved, and made accessible through various kinds of capital investment, land itself – at least in the economic sense in which the term 'land' was used by the classical economists - cannot be produced or reproduced by human labour, and is by definition a 'gift of nature' . For these reasons, the classical economists regarded the value of land as a surplus which is unrelated to any costs of production, unlike the returns earned by the providers of labour and capital.

However, towards the end of the nineteenth century the first members of the so-called 'neo-classical' school of economics put forward the idea that land rent is not the only form of economic rent, since earnings of wages or interest (the returns to labour and capital goods) may also exceed the cost of supplying the labour or capital for which they are paid . Thus, while the classical economists equated rent with the return to land, the neo-classical economists argued that some forms of economic rent arise simply as a result of the scarcity of a particular factor of production, such as a certain type of machine or a highly skilled worker, relative to the demand for the output produced by this factor. In the broadest modern economic sense of the term, 'rent' is surplus value that is unrelated to the cost of supplying the productive inputs from which it was created.

In modern economically advanced societies, economic rent tends to be *paid* by the relatively less well-off and *received* by a relatively small number of individuals and groups who have managed to enrich themselves by monopolising the various forms of rent. While there are some forms of rent that exist only as a result of regulations and restrictions that create barriers to entry into certain markets and industries, serving no useful social or economic function, there are also forms of rent – the most important being land rent - that *do* serve a useful social and economic function, or that *could* serve such a function were they claimed by society as a whole rather than by a privileged section of society. By 'exploitative rent-extraction', what I mean is the payment of rents that *should not* exist and the private monopolisation of those that *should* exist.

THE CRUCIAL LAND AND CAPITAL DISTINCTION

One of the many insightful contributions made by Henry George was his recognition of the full significance of the fact that the value of land may be regarded as a surplus which is unrelated to any costs of production. While Adam Smith identified some of the advantages of a tax assessed on land rent, and while the two Mills argued in favour of the socialization of *future increases* in land rent, it was left to George to outline the full implications of the law of rent, and to make the case for the socialization of land rent as a replacement for existing taxation. Part of George's motivation in developing and presenting his ideas was his understanding of the importance of land as a distinct factor of production which must never be conflated with capital. And George's understanding of the economic importance of land partly explained his focus on land rent as distinct from other forms of rent. While he was aware of the problems resulting from other forms of rent, his main concern was the monopolisation by private landowners of the rent of land.

Nowadays, of course, the tendency is to radically *underestimate* the importance of land and land rent. While mainstream economists are now becoming increasingly aware of the problem of rent-extraction, most do not fully appreciate the importance of land as a source of economic rent, and are concerned primarily with other sources of rent. For example, one major source of rents that mainstream economists have highlighted is the increasingly dominant position occupied by large tech corporations in the digital sector that gain 'first mover' advantages that allow them to monopolize the markets in which they operate. Digital giants (like Google and Facebook, Amazon, Uber, Airbnb, and so on) benefit from the significant 'network effects' generated by the vast amounts of data provided (wittingly or unwittingly) by Internet users . The concentration of data collection that results from these network effects generates a tendency towards the monopolization of the revenue that this data helps to generate, while at the same time giving digital market leaders a significant advantage in the development of new technologies.

While many mainstream progressive economists do of course recognize land value as an important source of economic rent, the scale of this particular source of rent is routinely radically underestimated, and its significance for public policy remains under-appreciated. A large number of economists, social theorists, politicians, and political commentators still seem to base their thinking on the mistaken assumption that land is much less important economically in the context of a modern digitized economy than it was in the context of the late nineteenth century, when agriculture was still a major sector of the economy. Part of the reason for this is the widespread failure to recognize the importance of the distinction between land and capital that George was so keen to emphasize. Within the tradition of neo-classical economics the tendency has always been to emphasize the similarities rather than differences between land and capital as factors of production . But while there are a number of features shared by land and capital as distinct from labour, the differences between the two factors are also highly significant, with very important implications for practical policy-making in relation to a wide range of issues.

As we have already seen, one key difference is that since the supply of land is fixed, the price paid for any given site consists entirely of economic rent. By contrast, while economic rent *may* constitute a significant component of earnings of wages and interest, in many cases the rent component will be very small, and in some cases there will be no rent component whatsoever. Even when rent does constitute part of the price paid for labour or capital goods, it can be difficult to determine how large the rental component really is, and how we should react to its existence. It is often not clear, even in theory, whether we should aim to reduce, eliminate, or socialize such rents, and how we should go about trying to achieve whatever we decide should be done. With regard to land things are much clearer: all of the earnings of land are economic rent, which we should aim not to reduce or eliminate, but rather to socialize.

Another important feature of land as a factor of production is that it is *limitational* in the sense that a certain amount is required for the performance of productive economic activity of any kind. Although capital can *substitute* for land, it can never *replace* land, since it cannot exist in the absence of the three-dimensional space within which it must be located. Capital intensive economic activities which do not require large amounts of physical space – such as the provision of IT services of various kinds – must still be performed in *some* location, and often in some *highly specific* location, such as a site in an urban centre in the vicinity of which significant numbers of appropriately skilled workers are residing. Economic activity that can be performed without access to large amounts of physical space may nevertheless require a large amount of land when measured by value.

What this means is that we can expect a substantial proportion of the value generated by productive economic activity – including advances in digital and other productive technologies - to be captured by those who find themselves in a position to claim the right to the rental value of the sites utilized for productive purposes. A substantial proportion of what are currently regarded as returns to capital and labour (including receipts from mortgage interest payments and bankers' bonuses) are in fact returns to land, which is every bit as important a source of economic rent now as it was in the nineteenth century. Even if, as some are predicting, advances in automation and artificial intelligence technologies lead to a future in which most 'work' is performed by robots, land will continue to play a central role in economic production, and will remain as one of the principal sources of economic rent. Robots need three-dimensional space in which to operate, their operators need three-dimensional space in which to live, and the goods that the robots produce must be stored in warehouses and distributed to customers who must also have somewhere to live and some means of paying for goods produced or services rendered.

THE ENVIRONMENTAL IMPACT OF EXISTING TAXATION

There are a number of ways in which the phenomenon of exploitative rent-extraction can be linked to the issue of the environment. First, the private monopolisation of land rent by a privileged section of society prevents the use of this value as public revenue, making it necessary to tax labour and capital goods instead. Many of these taxes (particularly business rates, employer national insurance contributions, and VAT) distort economic activity by penalising investment in carbon-saving capital goods and concentrating economic investment and activity in London and the South-East.

Consider first the impact of UK business rates, or National Non-Domestic Rates (NNDR), which is a tax imposed on the annual rental value of business property. This tax penalises investment in carbon-saving capital goods because while the 'business property' on which it is imposed *does* not include moveable capital goods like computers, furniture, inventory, and so on, it does include buildings and various forms of 'plant and

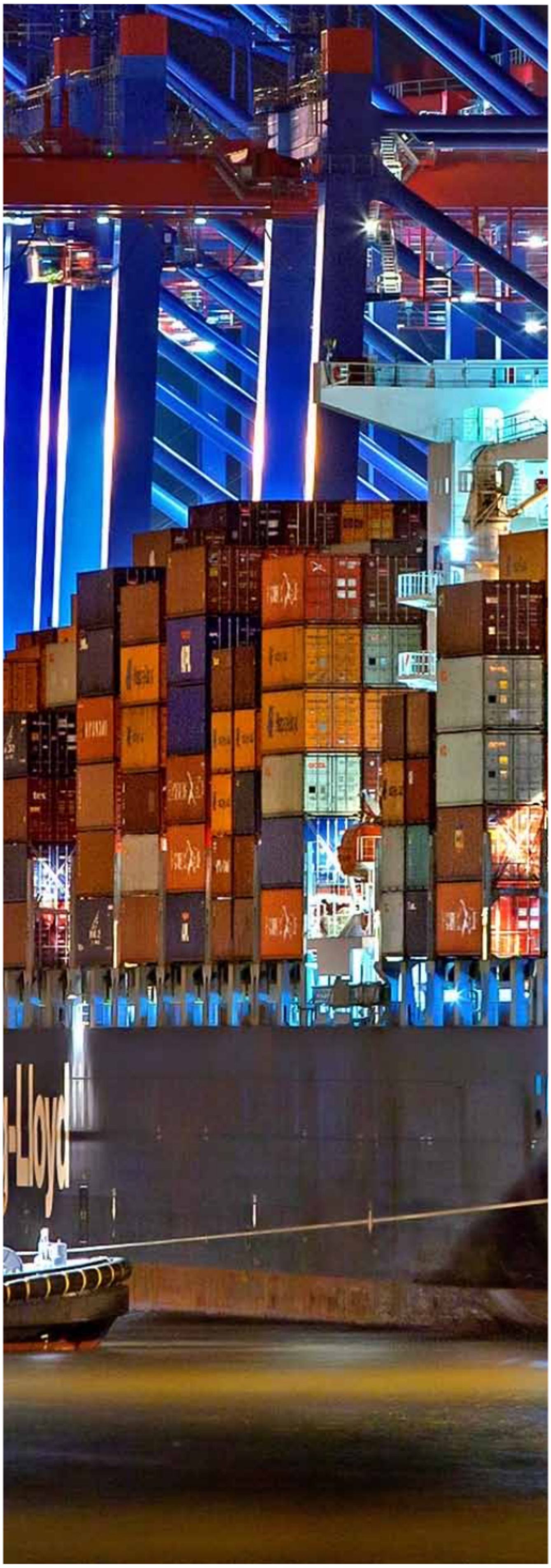
machinery'. This means that rates rise when businesses invest in new renewable electricity generation and storage infrastructure, such as onshore wind farms and large solar farms, as well as solar panels installed on the roofs of business premises, and even improvements to buildings in the form of more efficient lighting or heating systems.

As well as penalising investment in decarbonising capital goods, the NNDR undermine the economic viability of businesses in less well-developed areas of the country, where the productivity of labour and capital is at its lowest. Labour and capital goods that are highly productive in the most economically developed areas of the country – the centres of large towns and cities, particularly those in the South-East of England – are much less productive in areas located on the economic periphery, where there are fewer advantages deriving from agglomeration and network effects. For this reason, businesses operating in peripheral areas are much more likely to be marginal – only just profitable enough to cover their capital and labour costs – than businesses operating in areas closer to the economic hub. A tax like the NNDR that bears directly on investment in fixed capital goods will inevitably render sub-marginal some of the businesses which would have been marginal in the absence of the tax, since capital that yields only enough to cover its own cost will not yield enough to cover an additional tax burden. The result of such a tax is higher levels of unemployment and lower wages in less well-developed regions, as well as still weaker incentives to invest in productive capital.

It is also worth pointing out that other forms of tax that do not bear *directly* on capital investment – such as income tax, VAT, and the payroll tax – nevertheless do so indirectly . Income and payroll taxes are never borne solely by those earning the taxed incomes, but also by the businesses that pay the wages of those on whom the taxes are imposed. VAT is never borne solely by consumers, but also partly by producers. The direct taxation of the labour that operates capital goods and the value that capital goods add to raw materials amounts to the indirect taxation of capital investment. For this reason, such taxes would be just as damaging to businesses operating in peripheral areas as the NNDR if they did not incorporate significant personal allowances or thresholds below which business need pay no tax. Even with these allowances and thresholds, these taxes do a lot to undermine the viability of businesses in peripheral areas of the country.

Now, this is highly relevant to the issue of the environment for the following reason. One effect of the undermining of the economic viability of peripheral areas is of course the prevalence of poverty and deprivation in these areas. But another effect is that a large number of those seeking to engage in productive economic activity of some kind are forced to travel to less peripheral areas in order to do so. One consequence of excessive taxation in peripheral areas is that there is much more commuting and transportation of goods, and therefore much greater need for extremely costly and carbon intensive transportation infrastructure, and for the energy needed actually to run the cars, lorries, buses, trains, and planes with which people and goods are transported . We are so familiar with the vast and constantly expanding network of roads, and the ever increasing amount of traffic on the roads, that there is a tendency to take it for granted, to assume that this is all just one of the natural or inevitable features of a free-market economic system. It is worth considering the possibility that this aspect of our economic reality might rather be the manifestation of the profoundly distortionary impact of the excessive taxation of labour and capital that is necessitated by the private monopolisation of land rent.

Another way in which the taxation of labour and capital distorts economic activity is by diminishing the efficiency with which valuable commercial and residential land is used. Because business rates are levied on unused property or undeveloped land at reduced or zero rates, the tax creates perverse incentives to leave property unused, to leave land undeveloped, and even to demolish existing buildings. A similar set of problems applies in respect of residential land and the Council Tax. These perverse incentives exacerbate the tendency to speculation in rising land values that the privatization of land rent naturally encourages. As George himself pointed out, the confident expectation that land values will continue to rise motivates landowners to obtain more land than they can actually put to productive use, since they can reasonably expect the value of what they obtain to increase steadily. In this way, the extraction of economic rent replaces the production of wealth, and the scarcity of land is extended beyond its natural level. The urban sprawl that is the result of land speculation further increases the need for carbon-intensive transport infrastructure and energy consumption.



Thus, the taxation of labour and capital distorts economic activity in a variety of ways, and these distortions diminish the environmental sustainability of this activity. However, although I have been critical of existing UK property taxes, particularly the NNDR, I am certainly not suggesting that these taxes simply be abolished. Since the rental value of commercial property includes the value of the physical space within which buildings and other structures are located, business rates also capture and socialise a significant proportion of commercial land values. The outright abolition of business rates would provide a windfall gain to the owners of commercial property , and would allow landlords to increase rents and leases so that many businesses currently paying a combination of business rates plus rent or lease could in the long run end up paying more or less the same amount solely in commercial land rent . In the most economically developed regions of the UK, particularly London and the South-East, the value of commercial sites in town and city centres constitutes a large proportion of the value of commercial property. Moreover, in the absence of a tax that falls on the value of commercial land, a large proportion of the value of future public investment - in roads, the rail network, airports, Internet connection infrastructure, and so on – would also be privatised. For these reasons, simply abolishing the NNDR would lead to the privatisation of a huge amount of land rent. It would make much more sense to replace it with a commercial land value tax (LVT).

LAND VALUE TAX AS A GREEN TAX

The replacement of business rates with a commercial LVT would solve many of the problems caused by the former. Changing economic conditions resulting from developments such as the rise of online shopping, demographic change, further developments in AI and robotics, and so on, are reflected in higher commercial land values in some areas and lower values in other areas, which are in turn reflected in correspondingly heavier or lighter LVT burdens. Regular revaluations of commercial land would therefore prevent large disparities between tax liabilities and the potential productivity of taxed sites from arising.

Land value taxation is distinct from other taxes because it bears solely on the rental value of land, and not at all – whether directly or indirectly - on productive capital or labour. The close relationship between the value and the *potential productivity* of commercial sites means that LVT liabilities track *regional* economic productive capability in a way that liabilities generated by other forms of taxation do not. A tax liability that reflects the value of commercial land is a tax liability that takes account of the potential productive capability of labour and capital goods employed in any given location. For this reason, LVT is a form of tax that does not render marginal businesses sub-marginal, and does not generate unemployment, low wages, and under-investment in peripheral locations.

Because of its responsiveness to variations in economic conditions in different locations, the introduction of a commercial LVT as a replacement for the existing NNDR would greatly enhance the competitiveness of areas on the economic periphery, boosting employment and production in these areas, and facilitating the recovery of the many small and medium sized towns that have declined economically as the pace of digitalization has increased. Productive economic activity which might previously have been viable only in areas closer to the economic hub would become viable in peripheral areas. A larger proportion of the working populations of such areas would find themselves in a position to work *in the towns and cities in which they live*, rather than in more economically developed areas to which they need to commute. The need for roads and transportation infrastructure would be significantly reduced, as would the distance travelled by commuters, making future economic growth far less carbon-intensive.

The introduction of a residential LVT as a replacement for the Council Tax would also intensify the use of land in the centres of large towns and cities, leading to the utilisation of vacant buildings on valuable commercial and residential sites, the development of currently undeveloped sites, and the more intensive utilisation of currently underused sites. More intensive land use would in turn result in less urban sprawl and shorter lines of distribution, and would further reduce the need for the construction of carbon-intensive roads and other infrastructure. A residential LVT would also allow for reductions in VAT and regular payroll taxes, which would further enhance the economic viability of the economic periphery.

RENT-EXTRACTION AND PRODUCTIVISM

Critics of LVT sometimes argue that the introduction of this tax would distort economic behaviour by *artificially* intensifying the use of valuable commercial and residential sites, and by compelling the owners of valuable sites to work more than they might otherwise choose in order to generate the funds to pay a large LVT charge. One might argue on this basis that even if a shift in the burden of taxation from labour and capital to land rent would enhance economic efficiency, it would also artificially increase the rate of economic growth and result in a more 'productivist' society, thereby reducing environmental sustainability over the longer term.

In reality, however, a shift in the burden of taxation from labour and capital to land rent would do precisely the opposite – it would strengthen and expand the freedom of the majority of the population to determine how productive and materialistic their lives should be. This is because the private monopolisation of land rent benefits those who collect it at the expense of those who are forced to pay it. The rent received by landowners (and by bankers who receive mortgage interest payments in return for mortgage credit) is in effect a privately collected tax which is paid *in addition* to conventional taxation (including taxation paid in the form of lower wages and higher prices for goods and services). This means that in a society in which the state protects people's rights to use land exclusively for their individual purposes, land value tax cannot be avoided – the only question is whether it is privately or publicly collected (or, *to what extent* it is privately as opposed to publicly collected).

A shift in the burden of taxation on to the rental value of land would therefore free landless workers and capitalists from the need to engage in productive activity *on behalf of private rent-collectors.* It is the imposition of taxation on labour and capital, and the private monopolisation of rent that makes such taxation unavoidable, that has the distortionary effect of forcing workers and capitalists to perform more productive economic activity and to adopt more materialistic lifestyles than they might otherwise choose. Shifting the burden of taxation *away* from labour and capital and *on* to land rent would *eliminate* this distortionary effect, rather than generate it. Socializing land rent would enhance the freedom of the vast majority of citizens to determine for themselves the nature and extent of their participation in economic production and consumption.

As Henry George himself put it:

I shall not deny, and do not wish to lose sight of the fact, that while preventing waste and adding to the efficiency of labor, the equalization in the distribution of wealth that would result from the simple plan of taxation that I propose, must lessen the intensity with which wealth is pursued. It seems to me that in a condition of society in which no one need fear poverty, no one would desire great wealth—at least, no one would take the trouble to strive and to strain for it as men do now... When every one is sure of being able to get enough, no one will care to make a pack-horse of himself. Were this insane desire to get rich at any cost lessened, mental activities now devoted to scraping together riches would be translated into far higher spheres of usefulness.

Although George wrote these lines in the 1870s, if we consider the current housing shortage, the rise of zero hours contracts and the precarious self-employment of the gig economy, the use of food banks during the past decade, the numbers of people who are only 'just about managing', increasing mental ill-health, and so on, George's remarks still seem highly apposite.

Of course, it is impossible to know how people would respond to the expansion of their social and economic freedom that would result from land value based tax-shift. A large number might choose to carry on more or less as they currently are. But it does not seem too unreasonable to suggest that, given the opportunity, a significant number would choose to spend more of their time engaging in social, non-productive, non-materialistic activities like caring for the elderly, helping with the education of children, pursuing creative or artistic activities, playing music, cooking, taking exercise, and so on. This would presumably result in lower economic growth over the longer term, or at least in less carbon-intensive material consumption.

The burden of taxation borne by productive wealth-creating workers and businesses in the UK is certainly heavier than it need be, given the vast amounts of land rent currently being extracted and privatised.

A shift in the burden of taxation from the 'makers' to the 'takers' would generate a much healthier economic environment in which to produce, invest, and innovate. This in turn would reduce the need for carbon-intensive transportation infrastructure and energy consumption, as well as reducing or eliminating the direct taxation of decarbonising capital goods. An economic justice tax-shift would therefore also be a green tax-shift which would help make possible a sustainable future by enhancing rather than restricting economic and social freedom, and by removing the distortions resulting from the private monopolisation of land rent.