

# Public Choice and Land Tax Fairness

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**ABSTRACT.** *Land value taxation* (LVT) as desirable U.S. tax policy was brilliantly set forth by the American publicist and economist, Henry George, in the book *Progress and Poverty*, published 100 years ago. Economists concerned with *state and local taxation* have generally accepted the basic elements of George's analysis. The absence of substantial LVT legislation despite the economic efficiency and ethical strengths of land as a *tax base* arises from two sources. First, the public perception of land has not separated land's attributes from those possessed by other property. Second, *land ownership* data have not been gathered and publicized. Groups favoring taxes that promote *economic justice and efficiency* should support efforts to develop land ownership data. It would be an important first step toward fully utilizing the potential of LVT.

THE ANALYSES THAT FOLLOW are concerned with the strong support the taxation of land enjoys among economists and the failure of this tax base to find political support. Procedures are considered to gain the economic advantages of the land tax through the development of public choice based on fairness.

In 1974, George P. Shultz, formerly Secretary of the U.S. Treasury, wrote in *Challenge*,

"If efficiency is the cutting edge of economics, then equity or fairness is the *sine qua non* of politics, even though the concept may be used to support claims that arise from self-interest. In a governmental process, efficiency and equity often conflict so the economic policy-maker must often temper intellectual purity with equitable considerations that are defined in political terms. In familiar language, efficiency is not a good word" (1).

## I

### CLASSICAL AND GEORGIAN ANALYSIS

THE CASE for land value taxation has rested to a considerable degree on efficiency. To David Ricardo and Adam Smith writing in the late 18th and early 19th centuries, a tax on land captured purchasing power that was not required to bring forth the productivity of land and was, therefore, a tax that provided revenues for government

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without increasing costs or decreasing productivity of the operations of the private sector. The recipients of land rents, in addition, were seen to be spenders and not savers, and therefore, unlike the merchants, transporters and fabricators, were not providers of capital (2). Finally, both Smith and Ricardo saw a tax on land rent as a procedure for society to correct the injustice which arose because land prices absorbed much of the value arising from increased efficiency of labor and capital. The more society produced, the more it could offer to gain control over land and the space and productivity it provided. Therefore, the greater the productivity of a society, the higher the land values.

The justice position relative to land prices and land rent developed by the classical economists was expanded and popularized by Henry George toward the end of the 19th century. He summarized his position on the justice of land taxation, as follows:

In short, the value of land depending wholly upon the power which its ownership gives of appropriating wealth created by labor, the increase of land values is always at the expense of the value of labor. And, hence, that the increase of productive power does not increase wages, is because it does increase the value of land. Rent swallows up the whole gain and pauperism accompanies progress (3).

The Henry George position relative to land value and economic rent had moved away from the economic concept of efficiency of the system in making purchasing power available for capital investment, to the efficiency of the system in placing the fruits of its productivity into the hands of those doing the producing, and particularly the laborer, while not abandoning the usefulness of the land tax in expanding capital formation and full use of place utility and the productive potential of land. The George position, on the other hand, abandoned the classical position that any additional resources for labor only resulted in an expansion of the number of workers and not an increase in individual worker welfare. George saw land value taxation as a method of righting injustices and inefficiencies that were a part of the day-to-day functioning of democratic capitalism. It was both just, and possible, for the condition of the individual worker to be improved through the use of land rent to finance the State. This happy condition existed because prices were not increased and profits of capital were not decreased when land was used as the tax base.

## II

## NEO-CLASSICAL ANALYSIS

IN THE 1920S AND 1930S Alfred Marshall looked at the justice of land value taxation from quite a different vantage point. He related land rent much more closely to the actions taken by local government to improve the human condition of its residents. Although less broad in his sweep, Marshall followed in the tradition of capitalistic economics and its emphasis on the efficiency of the use of resources. He differed from Smith, Ricardo and George in that he limited his horizon to local government services and the uniqueness of land value taxation only in the finance of these services. He also considered the just manner in which a shift to taxation of urban land values can be made. He wrote as follows:

. . . from the economic and from the ethical point of view, land must everywhere and always be classed as a thing by itself. . . .

. . . when discussing the equities of the public value of land, that a sudden appropriation by the State of any income from property . . . would destroy security and shake the foundations of society. Sudden and extreme measures would be inequitable. . . .

. . . large expenditure is needed to secure air and light and play room. And the most appropriate source from which that expense can be defrayed seems to be those extreme rights of private property in land . . . (4).

Marshall sees land rent as different from other types of income and land therefore a unique type of property. He advocates deliberate steps by government aimed at acquiring land rents to cover costs of local expenditures that would better the life of the typical citizen. To Marshall, land value taxation is the appropriate tax, from both the ethical and the economic points-of-view, to finance social expenditures that are locally decided upon.

## III

## PHILOSOPHICAL AND POLITICAL SUPPORT

THE FOUNDATION for the extensive use of land value taxation appears to rest solidly on two of the three legs of good economic policy, *i.e.*, it is efficient and ethical. The third leg, public acceptance, is obviously weak and has prevented development of land rent as a major and separate tax base. The cause of the failure of land value taxation to gain the support enjoyed by income and profit taxes and even the retail sales tax and the payroll tax, must be that the public for one reason or another has perceived the various types of income and sales

taxes, and even the portion of the property tax resting on structures, to be more efficient and ethical than the land tax.

Why is this the perceived reality? How has it been accomplished? Why haven't the strong ethical and efficiency features of land value taxation attracted the public acceptance enjoyed by income and sales taxes?

One obvious explanation is that the public has not been given an opportunity to consider the land separate from structures and personal property. The desirableness of the property tax in the minds of the people includes consideration of the justice of a tax base consisting of a number of types of property and not a tax on the land alone.

#### IV

##### *MEASURING TAX ATTITUDES*

IN RECENT YEARS the Advisory Commission on Intergovernmental Relations (ACIR) has utilized the Opinion Research Corporation of Princeton, New Jersey, to learn citizen attitudes to property, sales and income taxes (5). In answer to the question which tax do you think is the worst—that is, the least fair—the position of the property tax has improved substantially since 1972. In 1972, 45 percent of the population identified the local property tax as the “worst tax” when compared with state income and sales taxes and the federal income tax. In 1975, the vote for the local property tax as the “worst tax” was 29 percent, very close to the state sales tax and the federal income tax, which were rated the “worst tax” by 23 percent and 28 percent, respectively, of the population polled. The shift in favor of the property tax was very substantial. Apparently a more favorable attitude toward the local property tax was registered by the farmer and farm laborer and the Non-White portion of the population in 1975 than in 1972, and this was a major cause of the change in attitude toward the property tax. In 1975, only 17 percent of Non-Whites considered the local property tax to be the “worst tax” while in 1972 some 39 percent of the Non-Whites had considered the property tax to be the “worst tax” (6).

#### V

##### *CIRCUIT-BREAKER AND PROPERTY TAX ATTITUDE SHIFT*

THE PERIOD 1972–75 when the property tax gained substantially in public favor was also the period when the circuit-breaker was introduced widely throughout the nation (7). The circuit-breaker, first

introduced in Wisconsin in 1964, now blankets the nation. Thirteen states adopted it in 1973–74 alone.

The aim of the circuit-breaker is to protect family income from property tax “overload.” The concept does not apply to commercial and income-producing property. It is strictly a procedure to reduce property taxes paid on homesteads plus an estimate of property tax included in rent payments for living quarters occupied by low income recipients. In addition, the circuit-breaker legislation frequently favors the aged homeowner.

The adoption of circuit-breaker legislation appears to have been a major factor in improving the public attitude towards the property tax between 1972 and 1975. The circuit-breaker appears to be on the right road in providing the “equitable considerations defined in political terms” needed to develop the third leg of good public policy—public acceptance (8). Also, of course, this was a period of rapid inflation and rising property values.

The ACIR studies summarizing the development of the property tax circuit-breaker and the attitude of the public toward major forms of taxes provide an idea of the direction required to gain public perception that land value taxation is fair. The legislation must make provision for exemption of small homestead land-holdings and also relate this exemption to taxable income of the taxpayer. At the same time as this is done, some of the basic economic efficiency and justice aspects of land value taxation need to be brought to the forefront. For example, it would improve the perception of justice of the land value tax if fairly complete and reliable data on land ownership by income class, of income tax and sales tax collections by income bracket and geographic area of the state, *i.e.*, county and city, were developed and published. These data are currently both inadequately gathered and disseminated.

The first step for a state and local tax reform program should be a study that identifies where the burden of state and local taxes rest. The political groups opposed to sales taxes and nearly flat rate income taxes should support this effort. When the task is done, the citizenry will have data available to evaluate fiscal fairness and potential productivity of different tax bases. The equity strength or weakness of land value taxation will be recognized. Public support of meaningful reform of the property tax and the general tax system of state and local governments should take on new life; at least, the information required to make informed judgments will exist.

## VI

## INCOME TAX FAIRNESS

THE FEDERAL INCOME TAX as measured by the ACIR 1974 opinion survey was considered most fair by 26 percent of the people. This compares with 24 percent for state sales taxes, 13 percent for state income taxes, 14 percent for local property taxes. A large 23 percent answered "Don't know."

In 1975 (when, as mentioned above, 29 percent of the sample of taxpayers picked the local property tax as the "worst tax") 28 percent so designated the federal income tax, and 11 percent so categorized the state income tax. The state sales tax was rated the "worst" by 23 percent and this time only 10 percent reported "Don't know."

Obviously the perceived equity of different tax instruments identified in the ACIR polls lacks internal consistency. However, it does appear that the reputation for fairness of the personal income tax, based on progressive rates that existed in the 1940s, but which have since eroded, has declined (10). The popular certainty of the basic justice of the progressive income tax, that economists trace back to the concept of decreasing utility and minimization of sacrifice and Jeremy Bentham's *Principles of Morals and Legislation*, is on the wane (11).

## VII

## FAIRNESS AND PUBLIC CHOICE

THERE HAVE BEEN TWO carefully researched analyses of the development of the income tax in the United States (12). The conclusions reached in the two studies relative to the influence of equity and fairness in the popular support of the progressive income tax at the federal level differ widely. The Blakeys conclude that the mass of the voters favored the income tax in 1913 because they wouldn't have to pay it. Goode concluded support was the result of a "general demand for justice in taxation. . . ." (13). More than likely they are both correct. But it is also perhaps true that the abstract concept of progressive income tax justice needed the reduction of the tariff on sugar and the fact that only 1 percent would pay the new tax, to carry the 16th Amendment through to final adoption. Today most everyone pays retail sales taxes, and an increased use of land value taxation that exempts the small landowners and renters of modest apartments while cutting retail sales taxes enjoys about the same

political-ethical advantage over the retail sales tax as the income tax had over the tariff on sugar in 1913.

Undoubtedly an aspect of justice not measured by ACIR is the manner in which the funds collected are to be spent. A tax closely tied to a desirable purpose, *e.g.* education or roads, enjoys greater public support than a tax to support bureaucrats in general. After all, benefit from the expenditure of taxes collected is a fundamental element of the traditional public finance concept of fiscal justice (14). It is also as difficult to measure and to reach agreement on justice enjoyed as is true of the tax-dominated fiscal justice of the ability-to-pay concept.

Another aspect of political-equity in taxation is the devising of a tax program so that the taxpayer is given some leeway in operating under the tax. For example, if a state introduces a value added tax to replace its retail sales tax at the same time as a statewide uniform land tax is adopted to finance basic education, agriculture units could be required to pay either the value added tax at the full rate or the uniform land value tax, depending on which was the greater (14). Tied in with this procedure, provision might be made for those experiencing extreme hardship to bring their individual situation before a tax court for adjudication.

#### VIII

#### CONCLUSION

FOR A LAND VALUE TAX PROPOSAL to be chosen by the public, the development program, and/or the legislation itself must include most of the points considered. In addition, in today's world of unemployment and inflation these economic goals should largely replace economic analyses that directly relate the tax to highest and best use of land. The economic efficiency basis of land value taxation also must be softened to emphasize its job-creating capacity and its increase in the purchasing power available for housing of those on fixed incomes.

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3. Henry George, *Progress and Poverty* (New York: The Vanguard Press, 2nd ed., 1929), pp. 88-89.
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13. Goode, *op. cit.*, p. 2.
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### *Local Policy for National Prosperity*

IT MAY COME as a shock for many to realize that state and local governments can assume an important role in macro-economic policy with the purpose of reducing non-productive income drains and thereby increasing the real income of labor and capital. For example, state and local governments can take measures for facilitating the entry of labor and business into existing markets.

A reduction in non-productive real income drains requires that total expenditures be limited so as to minimize the taxation of the non-surplus income of labor and capital. Top priority should be given to reforming the property tax so as to reduce or exempt the ad valorem tax on capital, *i.e.* improvements and personalty, and increase the tax on land values, which reflect the drain of economic rent by previous or present land owners. In addition, as many public services as possible, such as sewer and water, should be financed by service charges rather than taxes. [Excerpts from an address before the National Tax Association.]

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