Henry George School

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Political Economy

This lesson will illustrate the effects of the local property tax levied equally on land and buildings. It will contrast these effects with those of a tax on the value of land only to generate the same revenue. And it will give a quick summary of the course.

Over the last fifty years American cities have added a variety of other taxes to their property tax base. The largest is the wage tax. One important motivation for this is the enormous proliferation of tax exempt properties (nonprofit).

Let's take a large city like Philadelphia. It only collects 18% of its total revenue from property taxes, but that is a significant amount.

Let's say it is the mid 1980s, and you own a house on the edge of Center City. The place has a total market value of $150,000. If the building is in good condition and consistent with the development of the neighborhood, the house would probably be worth $120,000 and the land $30,000. If your total property value went up 4.8% a year, that would mean that the value of the building, which is a product of labor, would increase in value at about the general rate of inflation 3% or $3,600. The rest of the increase would be land value - 12% or $3,600. If the house could be rented for $12,000 per year, you would have the $12,000 cash and the $7,200 appreciation of your asset - total gain of $19,200

If we allow 3% for maintenance and depreciation, and 1% for management of your $120,000 building, that's $4,800 in expenses. The property tax rate in Philadelphia, and many other cities, is about 2.5% of market value for land and buildings. Your $150,000 asset would pay $3,750. Your total expenses add up to $8,550 Subtract that from total gain of $19,200 and you have a net gain of $10,650 If you divide $10,650 by your investment of $150,000 you would have received a 7.1% return. Now, a 7.1% return seems rather low for the mid 1980s, but every year the rent and the selling price were expected to go up more than inflation.

While there are vacant lots and empty houses in every city that are worthless, cannot be given away, there are also an overwhelming number of empty houses and vacant lots that cannot be purchased for tens of thousands of dollars. One might wonder why they do not sell, when they get no income at all.

Go back to the previous example: for $150,000 you could buy one house and one lot, or no house and five lots, at $30,000 each. You receive no income, but: the land value increases at 12% per year! $150,000 x 12% = $18,000. Your only expense is the property tax of $3,750 which leaves you with a net gain of $14,250 or 9.5%. Is it any wonder that people hold on to land from which they get no income?

Now go to the very best place you can find that has no value - that is to say, no land value. Many cities offer vacant lots and broken-down houses free. All you have to do to is to fix them up. Still, many of these properties have no takers.

Since the land is free, you could spend the full $150,000 on the buildings. You could build two $75,000 houses. You would gain 3% appreciation on the buildings - $4,500 offset by your expenses, which are 4% for maintenance and management of the buildings - $6,000 and 2.5% for the property tax - $3,750. The total is $9,750. In order to get the same 7.1% return, which would have been low for the 80s, if rents were not increasing, (Government guaranteed certificates of deposit paid over 7% during the 80s) the rent on each house would have to be $662.50 per month.

LAND VALUE TAX, PROVIDING THE SAME REVENUE

However, with a tax on the value of land only, land that had no value would have no tax. By saving $3,750 per year in taxes, 7.1% return would require the rent on each house to be $506.25 - over $150 less per month in rent.

In the City of Philadelphia the total land and building value is approximately four times the total land value. Therefore, to generate the same revenue from land as they are currently collecting from land and buildings, the tax rate must be multiplied by four. A rate of 2.5% on land & buildings equals a 10% tax rate on land.

Go back to the first example on the edge of Center City. The land and buildings were worth $150,000 x 2.5% = $3,750. The land was worth $30,000 x 10% = $3,000 There would be a $750 reduction in the owners' taxes.

Now take the speculators. Under the present system they would have paid the same 2.5%, or $3,750, and enjoyed a 9.5% return. If they paid a land only tax of 10% they would have paid $15,000 in taxes and experienced a mere 2% return.

This would not affect the selling value of the land, because it would not diminish the potential profits. However, it would so increase the cost of holding idle land that investors would be forced to provide housing. The same principles apply to commercial and industrial land. Shifting taxes to the value of land will create jobs and housing. The same principles apply to the wage tax and all other taxes within a city. Only if it creates a frontier, which raises wages and interest, will it lower the value of land. However, it will stimulate the redevelopment of the city. The best land will have the greatest incentive, and like the ripples from a stone dropped in the water, redevelopment will radiate back into the blighted areas, motivated by the exact opposite force out of they were born.

A QUICK SUMMARY OF POLITICAL ECONOMY

Labor applied to natural resources produces wealth. Capital, produced by labor, gives labor a greater efficiency. Title to land (the right of exclusive use) is granted to give the producer security to his/her product upon it. As the best quality land is taken up, population tends to concentrate in communities where their labor becomes most efficient. The owners of the most productive lands enjoy an advantage. This advantage is measured by the relationship between the productivity of better lands to those at the frontier. Wages and interest on all grades of land are equal to the production of labor and capital where the land is free. As the population tends to concentrate on particular lands and the frontier extends to less desirable lands, the advantage on all better lands increases. In the anticipation of increased land values due to increase in population, inventions and government facilities, land is hoarded. Certain portions of all grades of land are held out of use. When all the land is monopolized (there is no free land), wages fall to a bare subsistence and interest falls to a level below which the supply of capital would not meet demand. Every increase in production goes ultimately to the landowners. The more land is held out of use, the more workers are unemployed.

Taxing the value of land will eliminate holding it out of use, re-create the frontier, raise wages and interest and insure full employment.

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