

Is Russia Ready to Adopt the Theories of Henry George?

Commentary by Prof. Nicolaus Tideman — Translation by Tatiana Roskosnaya

The paper reproduced below was written by Olga Kaganova ("a member of the Honorable International Society of Land Economics, St. Petersburg") and Raymond Struyk (Program Director of the U.S.A.I.D. and Co-operation with Russia in Housing). It offers arguments against Russia's adoption of tax policies based on ideas of Henry George. The paper has been widely circulated among Russian municipal authorities. According to Professor Tideman, who comments here on specific points, "Some of the arguments presented by Kaganova and Struyk are completely unfounded. Others reflect reasonable concerns about the manner in which payments for land are implemented, without refuting George's fundamental idea, that governments should be financed by collecting virtually all of the rent of land."

The ethical basis of Henry George's ideas is that, because no one made land, no one can properly claim private ownership of it. The value of land comes from nature, from the growth of communities, and from the provision of public services. Therefore public services should be financed by charges on those persons who are awarded exclusive use of land. And, if governments refrain from taxing labor and capital, that will fulfill the ethical ideal of recognizing each person's right to what is produced by his or her labor.

There is also an important economic efficiency argument for Henry George's ideas. Taxes are generally levied in such a way that people can reduce the taxes they owe by being less productive. (Work less, and reduce your income tax. Sell less, and reduce your sales tax.) The payment owed for each parcel of land, on the other hand, is independent of how productive the possessor of that parcel is — productivity is unharmed when land is the source of public revenue.

Kaganova and Struyk correctly point out that the perceived security of rights is an important determinant of investment. If enough potential investors are alienated by leases, this will be a strong reason for using some other form of land rights. If, however, enough Russians feel that to grant titles of land ownership would be an iniquitous plundering of the heritage of all generations of Russians, that too should weigh heavily in the decision. There is a viable third option: Assign access to land through "titles of private possession," which would grant the right to determine how the land would be used into the indefinite future, be transferable without restriction, for any payment that was agreed between buyer and seller, and oblige the possessor to make regular payments to the local government equal to the rental value of the land.

From the perspective of economic theory, access to land need not be governed by titles of private possession. The choice of a name for the institution of land rights is a matter of deciding between the psychological needs of potential investors and the psychological needs of Russian citizens.

Yes, foreign firms can often take a credit against their domestic profits taxes for payment of a Russian profits tax. However, this is not reason enough for Russia to tax profits. It is as if foreign countries say, "if you will hobble your domestic firms with a profits tax, then we will give our firms a break on their taxes at home." The harm that is done to Russian firms and to the Russian economy by taxing production (rather than land) is not adequately compensated by the tax credit for foreign firms. Taxing land lowers the price of land and removes the superior access that foreign firms have to Russian land by virtue of their lower costs of capital.

The Russian constitution was presented to Russian voters for a single yes or no vote. There may not be majority support for private ownership of land — and even if there is, it is possible that many would find that a system of private possession of land provided the individual rights that they sought. It would be very surprising if Russian citizens insisted on a system of private retention of the rent of land irrespective of its adverse effects on their economy.

FOLLOWERS of the theory of American philosopher H. George — both in Russia and abroad — persistently advise the government of the Russian Federation to follow two basic principles while creating the systems of land relations and taxation:

- a) to preserve public ownership of land and to rent it to private users; and
- b) to increase public revenue mainly by collecting payments for the use of land.

This radical view has wide support in modern Russia. That is why it is important to pay serious attention to this theory....

Practical experience for the proposed system is rather scanty, for there are few governments in the world which implement such a radical program. Those who dared did it only partly. H. George's supporters usually use the example of Hong Kong and several cities in the United States, where a real boom in construction industry took place after the tax on buildings was reduced (though all other taxes were preserved.)

The land tax is attractive for its simplicity. But it is very important to examine the proposed program thoroughly before the final decision is made about its practical implementation in Russia is made. We would like to give the following considerations:

1. Which of the models, "private ownership" or "leasehold" will be more effective for the development of the property market will depend, theoretically speaking, upon the bundle of rights given by each of the models. If in the new land legislation there will be the opportunity to lease land for 99 years, to sublease land freely and to sell the leasing rights freely, then the "leasehold" model will be the stronger.

2. In modern reality legal guarantees of property rights and leasehold rights given by city authorities are not the same. It looks as if property rights received from the State suggest more guarantees. While leasehold rights determined by leasing agreements that state the most important terms, such as duration, review of rent, bases and probable increase of land rent, compensation to the leaseholder in case the lessee does not conform to the terms of leasing agreement, etc. Under the conditions of relatively lawless culture of society, extreme nihilism of town authorities, it is possible to foresee that the leasehold model will produce a lot of cases where interests and rights of leases will be neglected. This will, in turn, influence the flow of investments into city real estate.

3. From a political point of view, refusing to recognise private ownership of land means that one of the fundamental rights of the citizen that is mentioned in the new Russian Constitution is not recognised. It is important to remember that the promise to introduce private ownership of land was one of President Yeltsin's main declarations; should this promise not be fulfilled, it will automatically mean that the reform programs are discredited.

4. The introduction of the proposed reform of taxation will put Russia outside the international system of investment, because foreign capital will be double-taxed. In Russia, investors will pay the full tax which will be called "Land payments" and at home "profits/income tax." If the taxation systems in countries are similar, there are agreements between States about mutual recognition of tax liabilities.

5. There is no other way to determine land rent (if it is possible to do so at

These statements reflect a fundamental misunderstanding of the nature of rent. What economists mean by "the rent of land" is the amount of money that a person would pay for the use of unimproved land in a competitive market. If an owner of land allows someone to use land for less than a competitive market would offer, or uses land inefficiently, the rent of that land is still what the market would offer. The rent of land does not depend on how profitably the land is used. The rent of land varies continuously with location. Two adjacent parcels of land will have nearly equal rents, irrespective of any differences in how the two parcels are actually used.

The assertion that procedures exist to identify the profits of taxpayers will seem quite exaggerated to anyone familiar with business in Russia!

Collection of land rents does require skilled professionals, but it is not highly labor intensive. The identification of rent is not a matter of examining the records of enterprises, but rather of observing the market for land use and applying the proper adjusting formulas.

While it is true that Russian land cadasters are often not up-to-date, this is not a devastating problem. Governments only need to announce that the legal recognition of land rights will be contingent upon the payment of land taxes. Land cannot be hidden. It is easy enough to compare a map of all land with a map of land on which taxes have been paid, and announce that anyone is free to claim the land on which taxes have not been paid.

all) than to determine the revenue received from the property and to try to separate land rent from the total revenue. This is done when assessing the land value according to the income from real estate. But as in any case everything is based on income, which is the base for determining profit, debating whether to tax profit or to collect land rent is more an argument of terminology than an issue of substance.

6. The transfer from taxation of profits to collection of land rents is fantastically labour-intensive, if possible at all. It is well-known that a lot of enterprises disguise their profits, but at any rate, a procedure to register tax payers and their profits exists, and it works. The question is how to register rental income when the majority of legal entities are not the direct land-users, only renting a part of a building and very often not at their legal address, and sometimes illegally. There are no renewed registers which include, at least, official users of buildings, or full land cadasters of direct land users. At any rate, this is the case for the majority of cities. Besides, it is quite obvious that if land payments depend on the incomes of enterprises (and this is, as we see it; the basic idea for extraction of land rent and systematic review of rental payments), it means that enterprises will disguise their incomes as they are doing now with profits. This is the bookkeeping technique.

It is because the rent of land does not depend on actual profits that public collection of rent is such a beneficial way to raise public revenue. The payment that an enterprise must make for the use of land does not depend on its profits, but only on how much someone else would pay to use that land. The incentive for enterprises to make as much profit as they can is not diminished at all by public collection of the rent of land.

It may be true that no government collects the full rent of land, but landlords manage to come close. Actually, some governments do fairly well in collecting the full rental value of mineral leases. The trouble is that no government has tried to collect the full rental value of all of its land. It is reasonable to believe that if a government did try, it could manage to come fairly close.

7. The example given by Georgists of the construction boom in the U.S. cities where taxation of buildings was abolished and they are only paying land tax, can perhaps be interpreted the following way: advantages rarely appear, and then only in comparison with surrounding cities which preserved the former system. But it is possible to imagine that such a reform took place everywhere, as it is proposed for Russia, then the effect resulting from this difference in conditions will disappear. Besides, not long ago, there appeared evidence that if we will fulfil exact econometric analysis, results of the well-known Pittsburgh experiment can be explained only to a small degree by changes in the taxation of real estate.

No city in Pennsylvania has eliminated its tax on buildings. What 17 cities have done at various times is to shift some of their taxes from buildings to land. Dr. Steven Cord has compared rates of building in some of these cities with surrounding cities before and after the tax changes, and shown that these modest tax changes have induced significant increases in construction. It plausible that a full tax shift from buildings and production to land would induce a very large response in economic activity.

That is why we have to determine the clear criteria for evaluating the result before we start an experiment on any scale, and these criteria should be analysed by independent experts, perhaps international.

The question of the optimal frequency of land reassessment is worthy of detailed investigation. The answer depends on the volatility of economic conditions. With prices rising as rapidly as they have been in Russia in the past few years, it is essential that land assessments at least be adjusted frequently for inflation.

8. Nowhere in the world do they manage to collect the full land rent. This is recognised by Georgists themselves. The full realisation of this idea will possibly destroy the advantages of the centres of cities and their attractiveness to investors. For Russian cities it will be disastrous because centres are in particularly poor condition.

This again reflects a misunderstanding of what rent is. An assignment of value to land that is so high that no one is prepared to pay it is an improper assessment. Still, an assessor need not strive for absolute 100% land use. Just as a well managed hotel can have a few empty rooms for the travelers who might arrive, a well assessed city can have a few unused parcels of land that new entrepreneurs can acquire at any time. What would make the centers of Russian cities attractive to investors would be the combination of available land at affordable prices and the reduction or elimination of taxes on their productive activities.

9. Regular review of land rent, for example annually, will of course discourage investors. Obviously, in the course of time, this problem will be sensibly solved. Authorities of those cities who will be especially active will gradually understand that they are losing investors. But now, when there is no experience of sensible land policy, and the cities need urgent investment, such orientation of local politicians can be especially harmful.

Arguments given here confirm our opinion that there are no reasons to adopt the programs of Henry George followers for payments from the land. More than that, we are worried that Russia will start once more to experience new, practically untried ideas. The country once followed this way in 1917 and the results were rather poor.