TAX EXPORTING VS. TAX ECONOMICS

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Tax Exporting vs. Tax Economics

Two economists stood on a platform with two politicians in Louisville, 1977, addressing the National Tax Association. The subject was Intergovernmental Competition for Energy Revenues. The politicians were Byron Dorgan, now Senator from North Dakota, and Sidney Goodman, Michigan Commissioner of Taxation. The economists were as different from each other, and from Charles McLure, as Warren Samuels and myself. Yet we two sized up the question much as Charles McLure has in his careful essay.

The economist sees tax exporting mainly as a transfer of rents (and therefore of land values) among jurisdictions. He does not wax moralistic or righteous on either side, for the interstate distribution of rent-sources was initially arbitrary, and is subject to constant windfalls and a few wipeouts as shifting world markets give some here and take from there.

Nor does he see much scope for states to export taxes anyway. Most taxes, whatever the nominal base, come out of the taxing state's own rents. That follows simply from the interstate mobility of national pools of labor and capital: migration and arbitrage operate to equalize after-tax returns. But land cannot move among tax jurisdictions which are defined as fixed areas of land. John Locke (1632-1704), François Quesnay (1694-1774), and Adam Smith (1723-90) had this rather well thought out over two centuries ago. It is often called the Physiocratic doctrine of tax incidence, after Quesnay, but is by no means peculiar to Physiocrats.

The politicians speak from different perspectives. Much was made of "a fair shake for the homeowner" (farmer, consumer, worker,

pensioner, etc.) Both politicians assumed full forward shifting: prices are based on cost plus tax. All "costs" to them are lean and hard and ineluctable; all needs are fixed, with survival at stake. There is no slack or fat in the system. Put another way, they see highly elastic supplies and inelastic demands, with the latter based not on consumer affluence but consumer desperation. Thus there is no give, no cushion, so everything is marginal, and every adjustment is calamitous. These are, of course, strong initial bargaining positions from a certain world-view, but weaker, it seems to me, than the view that each state is taxing primarily the rent of lands under its undisputed sovereignty.

Both politicians seemed to accept a ground rule that North Dakota had to justify its taxes by benefits delivered to miners, or by costs which miners impose on the state. Monetary expenses and environmental damages were acceptable chips in this game. It was not enough merely to note that each state enjoys a sovereign power of taxation not limited by benefits (at least in the usual narrow construction). Some economists seem prone to this view as well, and lawyer Henry Monaghan, speaking at this conference, has a firm impression that we are _all_ like that, faithful copies of Frank Knight and Milton Friedman. Charles McLure, with his emphasis on benefit taxation, may be fortifying the impression.

If it be true that land value is a social product, then an _ad valorem_ tax on land is a benefit tax. But the usual benefit doctrine today is more narrowly construed, by a far piece. It is more

like the old joke whose end line goes "Yes, but what have you done for me lately?" One lawyer referred to a railway protesting a tax with the plea "What is the state doing for us, keeping the Indians away?" How easily we forget that Custer died for our sins. Sovereignty over land comes from power; power costs lives and money, and creates a continuing obligation in the landholder to support the sovereign from whom he holds title. That was the feudal law, the feudal law shaped the common law, and the common law is our law.

More generally, Alfred Marshall described land value as a "public value" resulting from public spending (including that which establishes and maintains sovereignty), and spillover benefits from the use of complementary lands. None of these being created by the holder of land, they must be benefits received as a consequence of holding title. The logical upper limit of benefit, therefore, is value; the supposed excess of value over benefit received is an illusion, and ad valorem taxes on land are benefit taxes.

The only moot question is from which sovereign are the benefits derived, the original federal grantor, or the state? This question seems largely answered by federal abandonment of direct property taxation to the states.

Beyond that, I agree with the main lines of McLure's analysis, and content myself with trying to fill some gaps which strike me as too important to leave empty; and to register, in one respect, a disappointment.

The disappointment is on the spiritual level. A correct analysis like McLure's is inherently a positive contribution, but what is the message for suffering mankind? Such great technical skill and virtuosity as McLure displays should not be spent on small purposes, yet the paper suffers from a certain aimlessness. This is a cautious "caveat" paper, carefully disclaiming most aims. The only avowed aim is to show that incidence can be complicated. We already knew that.

It is as though one went to a surgeon with abdominal aches and he said "I could cut out your appendix, but let me first tell you how many things could go wrong. Let us begin by noting that the city power supply could fail . . ." The style calls to mind what Knut Wicksell said of Eugen von Böhm-Bawerk: "He delights in piling up difficulties, in order that he may remove them later." Wicksell greatly admired the Austrian, recall, just as I admire McLure. We only seek improvement because what is there is already valuable.

Thus McLure's message is muted and uninspiring when it could be constructive and seminal. He could, for example, use his tools to show that a severance tax imposes excess burdens, and that there are better ways to tap rent for the fisc. In a way he does lay such a message between the lines, when he indicates that "income taxation" is a better way to tap rents. But this is too easy. If the "income tax" really were aimed right to the rent bull's-eye, marvelous. Let us move from the spiritual to the substantive

and fill in the gaps left when income taxes are equated with taxes on rent.

Income, in normal usage, refers to returns imputable to all equity assets. These include capital used to develop land. On marginal land such taxes are not on rent at all, as there is none. They simply sterilize the land, as a severance tax does (and thus lend what credence there is to the tax exporting hypothesis).

Debt capital is deductible and therefore excludible from taxable income. A highly leveraged corporation then presents virtually no tax base at all, however much valuable coal it controls.

The income tax, personal or corporate, is not *in rem* but *in personam*. For individuals, the base includes value added by personal service. For individuals and corporations both, it invites use of world income, with arbitrary and contestable apportionment formulae; tax avoidance by cute transfer pricing; allocation of out-state costs to local profits; transfer of tax credits; etc. *ad inf.* After all that is done, the base is not much related to local land rents as the tax base.

In this paper, and all the papers here, I miss any recognition of this vital distinction of *in rem* and *in personam*. When we say "rent" we are talking of an *in rem* concept: the income imputable to land, regardless of who owns it, of his personal circumstances and shelters and dodges and residence and citizenship and partners and wives and debts and medical bills and deductions and exemptions. Rent is an objective fact, peculiar to a parcel of land sited unequivocally in a given tax jurisdiction. "Income" changes all that

to the *in personam* mode, and it is grossly misleading to equate income and rent, or to suggest any analogy.[1]

There do exist taxes on land income which are *in rem*. They are called Net Proceeds Taxes, and are found in Nevada, Idaho, South Dakota, and a very few other states. The taxable unit is the parcel of mining land. The tax base is gross receipts less expenses on the specific parcel.[2] Another tax of the same genus is that levied on copper in Papua-New Guinea. This tax is conceived and defined as a tax on pure rent. It was drafted by economists Ross Garnaut and Anthony Clunies-Ross. It is central to the subject of this conference, and McLure's paper, that such taxes do exist and are understood to be taxes that hit the bull's-eye of rent, free of most excess burdens other than those of an administrative nature.[3]

There is yet another vital concept that eludes this paper and this conference: the one that A.C. Pigou called "the announcement effect."[4] This effect is the one that causes excess burdens. It comprises the taxpayer's avoidance maneuvering when it is announced to him that he is subject to a tax which, like most taxes, "shoots anything that moves" but spares what stands still. Income taxes, severance taxes and net proceeds taxes, all three, are on a "unit-of-production" basis: no production, no tax. They only tax rent ex post, i.e. as realized.

Very different in this respect is the property tax. Here, the "taxable event" is not production but the arrival of an anniversary on the calendar. The incentive effect of such an announcement is

the reverse of most tax announcements. Here the taxpayer is not like a share tenant of the state, but a cash tenant. He pays for the privilege of tenure, and then does what he pleases. As Pigou observed, the property tax on bare land has zero announcement effect, unlike other taxes. He counted this in its favor.[5]

In effect, the property tax makes rent a first claim on production. The entrepreneur gets the residual. Others have noted that this tax therefore works to increase production, especially if levied on land alone, exempting capital. The implications for our subject are profound. This tax could never be exported, could never obstruct interstate commerce. If anything it benefits consumers by increasing supply. Consuming states could never claim injury from such a tax.

Absentee owners might claim injury, however, and this is probably what all this fooferah about tax export is really all about. States like North Dakota and Montana are basically colonies, their coal mainly owned by foreign corporations. When these states tax coal, they are taxing these absentees. But the latter are rich, organized and influential. It is they, I surmise, who stir up the rabble with all this outcry about tax export. It is they whom James Madison set out to protect with his checks and balances calculated to break up and abort "factions" who might want to tax property. It is they alone who always have standing in court because they own property and who therefore inevitably become the major focus of

lawyers' concerns. At the same time it is they who lack any ultimate defense against taxation because our common law makes them tenants of their sovereign who may assert his overriding ownership of land as "he" -- i.e. we -- please(s). So they plant myths about tax export and then seek to enjoin these mythical effects. I do wish that Dr. McLure had explored this side of his subject.

My last point is that interstate collusion to restrain trade, as envisioned by McLure, is most unlikely. States simply are not organized that way. I dwell in the most suspect of states, California, with its many farm specialty crops with national monopolies, its farm prorates, and its producer coops, all sanctified by Capper-Volstead and the case of Parker v. Brown. What do we do with these dangerous powers? Now and again we burn some oranges and knock down green peaches, but we never block the entry of new lands into producing these things. On the contrary, we habitually subsidize and promote this, to the extent that many of our older producers are ruined by oversupply and low prices. The simple force behind this behavior is that our richest, most politically effective people know that the way to prosper is to buy cheap dry land ahead of settlement and then get the state to water it, road it, and so on.

Economists' traditional concern with monopolies and artificial scarcities misses the mark here. I do not question that there are monopolies: Vermont marble may be a good one. But our states' high propensity to subsidize the development of submarginal land creates

a problem rather of artificial abundance in the things subsidized. The scarcity that ensues then is a general shortage of capital for all other things. If we eat the seed corn to sustain us while building roads into the wilderness, how then shall we plant the new land? Compared to this outcome, mere monopoly seems relatively benign. It is this pattern, I suggest, which has set us up for a long time of troubles ahead, to mend which economists should now turn their major efforts.

NOTES

1. Cf. Mason Gaffney, "Objectives of Government Policy in Leasing Mineral Lands", in A. Thompson and M. Crommelin (eds.), MINERAL LEASING AS AN INSTRUMENT OF PUBLIC POLICY (Vancouver: University of British Columbia Press, 1977), pp. 3-26.

2. Robert Paschall, "A Comparison of Minerals Tax Systems", THE ASSESSORS' JOURNAL, December, 1977, pp. 221-37.

3. Ross Garnaut and Anthony Clunies-Ross, "A New Tax for Natural Resources Projects", in A. Thompson and M. Crommelin, op. cit.

4. A.C. Pigou, A STUDY IN PUBLIC FINANCE, (Third Revised Edition, London: MacMillan & Co., Ltd., 1949)

5. Pigou, op. cit., Chapter XIV, "Taxes on the Public Value of Land", pp. 147-53.

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