Land Value Taxation: Could It Work Today?

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Abstract

Decades before Henry George made a passionate case for the "single tax" in ***Progress and Poverty*** (published in 1879), the classical economists had recognized that, in theory, the land value tax was almost the perfect tax. Unlike other taxes, it causes no distortions in economic decision making and therefore does not lower the efficiency of a market economy in allocating resources. Also, it was obvious in the nineteenth century that a tax on the value of land would be highly progressive.

There was a strong moral basis for the land value tax, as well. Land value increased over time because of growth in population and improvements made by the community, either in the form of utility infrastructure or transportation investments by government and the private sector. Individual landowners did nothing to increase the value of their own land but rather realized "unearned increments" over time, unlike those who contributed labor and capital to production and thus earned their compensation.

In George's day there was little question that the tax could provide adequate revenue, at least in the United States where the role of government was small-no more than a tenth as important relative to gross domestic product as it today. Virtually all government services were supplied by local governments, which relied entirely on property taxes. Today, many scholars and practitioners question whether land value taxation is a serious contender as an important revenue source. But, whatever its political potential may be, economists continue to find the theoretical case for land value taxation compelling.

In January, the Lincoln Institute sponsored a conference to address these issues: "***Land Value Taxation in Contemporary Societies: Can It and Will It Work?***" In the opening paper, William Fischel focuses on the special nature of local government in this country, stressing its importance as an instrument of enhancing property values within communities. He argues that, in pursuing that role, local land use controls actually achieve substantial efficiency advantages by more closely matching consumer preferences to local government services and taxes. This is what economists refer to as the Tiebout-Hamilton model.

Fischel maintains that there is substantial justice in this outcome, which might be improved only marginally by land value taxation. That is, land use controls permit local governments to appropriate much of the value generated by community

growth. Moreover, this system is widely used, which argues that it is more workable than land value taxation, although the latter is, in principle, more fair.

Efficiency of the Land Value Tax

Two papers treated the efficiency characteristics of the land value tax. Edwin Mills examines the issue in the context of an urban economy, showing that the tax is indeed efficient in its effects on land use, as claimed. But he believes that this is immaterial because the land value tax cannot yield more than trivial revenues, even at rates that are so high that the courts would find them to be an unconstitutional "taking" of property. Moreover, it is so difficult to value land properly that the efficiency advantages cannot be realized.

Thomas Nechyba explores the land value tax in the context of a general model of the entire economy. He develops what is known as a "computable general equilibrium model" that quantitatively describes the changes in the macro-economy that will occur with the substitution of the land value tax for income taxation. Given his assumptions, the model predicts that the reduction in taxation of capital will so increase the aggregate amount of capital that the demand for land on which to use the capital will generate substantial increases in land values. That in turn will permit the land value tax to generate considerable revenues at a rate that is not confiscatory. Most economists would consider the significant increases in total national output predicted by the model to be real gains in economic efficiency.

Land Value Taxation as a Substitute for Other Taxes

Another pair of papers examines the land value tax as a substitute for other taxes used by sub-national governments in rich countries. In my own paper I argue that, although the empirical evidence on land values is poor, some reasonable estimates suggest that, at least in the United States, the land value tax could replace the conventional local property tax at reasonable tax rates. But the main thrust of my argument is that those rich countries in which substantial government spending is done by local governments are the most plausible candidates for the use of the land value tax (see Table 1). Furthermore, its use is probably most feasible in those countries familiar with the idea of valuing real property for tax purposes. The combined administrative, compliance and evasion costs of most other taxes are so large that, even if the administrative costs of land value taxation are high, land value taxation is still promising.

Andrew Reschovsky points out that the current balmy climate for state and local finance in the United States is likely to change radically, for the worse, in the not too distant future. For a variety of reasons, state governments in particular may be looking for substantial additional revenues. Is the land value tax the right, or the likely, choice for hard-pressed state governments? He concludes,

- first, that the economic gains from the adoption of a new land value tax would be modest, compared to increasing the rates of existing state taxes.
- Second, a land value tax should help improve the equity of the state tax system.
- Third, he believes that it would add an element of cyclical stability to state revenue systems.

Nevertheless, Reschovsky remains skeptical about the tax on administrative grounds and is not convinced that it can generate enough revenues to replace any important existing state tax source. In the case of large central cities, however, he rates the land value tax somewhat higher as a replacement for existing tax sources, largely because of the probable lack of adverse locational effects. He views it as especially appropriate for those cities like Philadelphia that now receive relatively small percentages of tax revenue from the property tax.

Roy Bahl reviews the many difficulties and deficiencies in the use of property taxes by local governments in both developing countries and former Communist countries. There is widespread agreement that the property tax is the appropriate major local government tax, and in some countries this agreement extends to site value taxation as well. But, Bahl notes, the property tax usually provides negligible revenues, because of low nominal rates, low and inaccurate valuations, and poor collection experience. Almost everywhere, the basic requisites of good administration are lacking. Moreover, the political unpopularity of the tax generally is far greater than in the United States. Nonetheless, the property tax, especially the site value tax variant, is considered the best local revenue source in these countries.

Perhaps the most surprising research finding reported at the conference was the conclusion of Edward Wolff, who has written extensively on the distribution of income and wealth in the United States. He suggests that substitution of the land value tax for the federal individual income tax would make the U.S. tax system less rather than more progressive with respect to income (see Table 2). This result may be explained by the fact that the ratio of the value of land owned to household income rises steeply with the age of the householder. That is, mean household income declines sharply with age after age 54, while the mean value of land owned declines only slowly. On the other hand, a land value tax would be much more progressive with respect to wealth than is the income tax.

Broader Principles and Questions

Nicolaus Tideman, a convinced follower of Henry George, argues that the basic principles of and justifications for land value taxation apply to much more than the problems of land use in cities and suburbs-the usual focus for discussion of this form of taxation. He offers applications to environmental, congestion and population problems and to questions of efficient resource use and economic growth on a worldwide scale. He bases his views on the general principle that "all persons have equal rights to natural opportunities and should therefore pay for their above-average appropriations of natural opportunities."

Throughout the conference, there was lively disagreement about whether the land value tax could really produce substantial revenues. Some, like Mills, held that it could not even replace the conventional American property tax on land and buildings, much less a substantial portion of other state and local taxes as well. Others, including Tideman, Nechyba and I, presented data that suggested the possibility that land value taxation indeed could be an important factor in the American fiscal system. Participants also discussed the problems of administering a land tax so that tax liabilities actually and accurately reflect the value of individual parcels of land as bare sites, which is essential if the tax is to be a truly efficient one.

The conferees did not produce an agreed answer to the basic conference question, Can and will land value taxation work today? But they made it clear that the question remains a relevant one that deserves serious and continuing attention.

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Land Value Taxation in Contemporary Societies: Can It and Will It Work?

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