What do we need to know about land value taxation? (Public Policy Implications).

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Introduction

MORE THAN A century ago, Henry George concluded that poverty existed in America's rapidly growing cities in the midst of unparalleled rates of economic growth and prosperity for some people because the owners of land and other "natural opportunities," who do not contribute to the productive process, were appropriating the fruits of labor and capital. His solution lay in the taxation of the rent of land and natural opportunities -- that is, the recapture of rent for public use, rather than the taxation of labor and capital. George's insights were foreshadowed in the writings of the classical economists a few generations before him. They, however, had not pressed ahead with the policy implications; in Progress and Poverty, George did just that.

The political movement created by that book had some early, partial successes in the form of adoption of various types of differentially heavy taxes on land. But, by World War I, the momentum had given out, and there were some retrograde developments, like reducing the already low taxes on land in some places (notably, the local "rates" in England and Wales). There have been very few political successes since then.

In recent years, more and more public finance and urban economists have had positive things to say about land value taxation, but with no policy effect. That lack of success has always been something of a mystery, and there are various unproven hypotheses to explain away the mystery. At least one explanation that has a degree of plausibility is that land value taxation has an antiquarian flavor about it. From this perspective, it was a good idea in its time (when the only important level of government in the U.S. was local, and the only important tax was the property tax), but the world is so much more complicated today, and its problems call for complicated solutions. So there is an obvious challenge: is land value taxation still relevant to and feasible in today's world? To respond, we need to answer the question in the title of this essay: what do we need to know about land value taxation?

Economists and Land Value Taxation: Then and Now

I AM ABOUT to take some liberties, but the story might best begin by looking, in very general terms, at what we economists knew about land value taxation thirty years ago and what we know now. I choose thirty years ago, because there was little attention by economists--in North America or anywhere else-to the property tax, in any of its manifestations, from about 1930 until the 1960s. In the U.S., most public finance economists had been convinced that the property tax was a dying, anachronistic institution by three factors: 1) decades of savage criticism of the low quality of tax administration, which had not improved much, 2) the collapse in property tax collections during the Great Depression of the 1930s, and 3) its replacement by state-collected sales or income taxes. As late as 1956, a leading economist forecast that, in another 20 years, "the property tax will ... have become an all-but-forgotten relic of an earlier fiscal age" (Mitchell 1956). Even as he wrote, however, the role of the property tax in American state and local finance had stabilized. A new decline began in the mid-1960s, to be followed by stabilization in the years since 1980, but in the late 1950s, economists began to examine the property tax once again, and an extensive literature emerged.

What did we learn specifically about land value taxation from that literature? As you will see, I do not think we learned a great deal. To me at least, that is reason enough for first-rate scholars to direct their attention to the appropriateness of land value taxation in the contemporary world, which is now being done under the sponsorship of the Lincoln Institute of Land Policy.

Thirty Years Ago

The state of knowledge of land value taxation in the economics profession up through the 1960s can be summarized as follows:

1) The theoretical literature on land value taxation after Henry George was very sparse indeed. In fact, the only noteworthy theorizing was done by Harry Gunnison Brown, a person whose name few recall, who spent his long career at the University of Missouri, in the 1920s. Brown said to me twenty years ago that his main contribution was to put the theory in the language of contemporary economics. I think he went further, by analyzing how other taxes (notably consumption taxes) created substantial deadweight losses in the form of distortion of economic choices, to the extent that those taxes are not shifted backward to landowners.

2) The very definitions of what precisely, land value taxation is--which was clear enough to Henry George--had been muddled by his critics, particularly the virtually "sainted" Richard B. Ely. (1) Advocates of land value taxation frequently spoke of quite different taxes as if they were truly taxes that recapture the rent of land, and they seemed ready to accept "approximations" that sometimes had little in common with land value taxation. (2)

3) There was almost no scientific evidence on the effects of land value taxation in practice. There were anecdotes about the effects of differentials in the taxation of land and buildings in different places in English-speaking countries, but the anecdotes were utterly unpersuasive. Frequently, they had the character of visions seen by the devout. In part, this was because the real-life cases were few, idiosyncratic, and rather distant from rigorously-defined land value taxation.

4) While all advocates would have agreed in principle that land value taxation required proper valuation of land, many seemed willing to accept extremely bad valuation practices and used data from such practices as arguments in their anecdotes. There was little serious attention to valuation issues.

5) There had been almost no empirical work on the issue of the capitalization of taxes into prices of land, aside from a bit of work on farmland done in the 1920s and summarized in Jensen's splendid 1931 book on the property tax in the United States.

Where Are We Today?

Based on work done in the last thirty years, we know a bit more now than we did in the 1960s:

1) There has been some theoretical work on land value taxation, but not a great deal. One strand of this is within the field of urban economics. William Vickrey, among others (but he most forcefully) advanced the theorem of the optimal system of urban public finance: marginal cost pricing plus land value taxation, the latter to cover services where marginal cost is below average cost and to finance services not suitable for marginal cost pricing (Solow and Vickrey 1971; Vickrey's essay in this volume). The implications of this have had some attention, beyond the virtually universal acceptance of the theorem by urban economists.

2) Another strand has been the theorizing about the effects of land value taxation on the timing of development, which has had some interesting theoretical fall-out (Arnott 1996). The outcome of the timing controversy has been real attention to the definition of land value taxation. Again, Vickrey (1970) had no doubt about this, but the issue of how to define land value taxation was treated properly only after the charge was made that it distorted the timing of development. (3)

3) There has been some serious empirical work on the effects of actual cases of differential taxation of land. The persuasive studies have shown mixed results. The Australian studies show virtually no effects (but in the context of trivial tax rates); the Pennsylvania studies funded by the Lincoln Institute showed strong positive effects for Pittsburgh and no statistically significant effects for the smaller cities (Woodruff and Ecker-Racz 1969; Oates and Schwab 1997). (4)

4) While advocates typically remain airy about implementation with respect to valuation, a number of writers and practitioners have given the issue serious attention. However, I see some retrogression in the advice now being given by American experts to would-be taxers of real property in the formerly Communist countries, along the lines that anything is good enough to start with.

5) Perhaps the biggest change has been the extensive amount of work done on capitalization of tax differentials. Despite the extraordinary difficulty of empirical work in this area, that work has led to a fairly clear understanding of how the process really works, and what impedes rapid capitalization, an understanding that is essential in a newly introduced land value taxation system. (See, for example, Case 1978 and Yinger et al. 1988.)

Future Research Needs

SO, WHAT DO we need to know? In order to make land value taxation intellectually and politically acceptable, a number of questions will need to be resolved with further research.

1) The Ethics of Land Value Taxation

To Henry George, land value taxation was the efficient way of raising money for government, but the main argument was an ethical one. It is the ethical argument that spawned a Georgist movement. The fundamental ethical justification proposed by Henry George for land value taxation was, as is well known, the fact that the site value is created not by the individual owners of sites but by the community, acting in two capacities. First, the larger community was the provider of infrastructure (often through private monopoly utilities awarded territorial exclusivity and eminent domain powers by political bodies) and of the legal institutions of land ownership and land use. Second, the community, in the shape of markets, was the means that caused local economies to grow and develop. The ethical conclusion is that the community, not the individual site owners, should recoup the fruits of these community actions.

An important contemporary dimension of this is the ethical appropriateness of taxing land rents where local governments exercise land use controls and continually act to increase land values in their communities. Indeed many local governments act as if their main goal were to maximize land values within the jurisdiction. Under these circumstances, land value taxation may or may not be an ethical improvement. Moreover, land use controls have a mixed press among economists. On the one hand, the existence of land use controls is essential to the one efficiency solution for the local public goods problem that economic theory has offered, the Tiebout solution (Tiebout 1956). On the other hand, land use controls increase the costs of housing and urban public services, and almost certainly have inequitable effects among income groups in urban areas. It is not clear how land value taxation would affect that argument.

There is also need to examine, in the contemporary context, the most common ethical criticisms of land value taxation. One problem is that recent buyers of land unjustly become victims when a new or greatly increased land value tax is instituted. (Is this a more or less serious issue today than it was decades ago?) A second problem is the existence of other types of economic rents that go largely untaxed, which struck the opponents of Henry George as terribly important a century ago. Interestingly, some of the leading scholars in the field of taxation now maintain that the income tax can be truly equitable and efficient only if "income" is defined as ability or capacity, that is, the natural opportunity biology affords individuals. This would convert the tax into one on non-land rents. If we say, crudely, that any wages and salaries earned in excess of $20,000 reflect differential innate ability, then there was about $1.3 trillion in this type of economic rent reported on federal individual income tax returns in 1993 (US Bureau of the Census 1996, Table 527), which probably is in excess of the economic rent stemming from land.

2) Efficiency in Land Use

Urban economists generally agree that land value taxation is likely to be neutral in its effects on land use in most respects, unlike other forms of taxation, especially the conventional American property tax. It is, therefore, regarded as more efficient. But there are a host of questions, granted the validity of the theoretical proposition. For example, how dependent is this outcome on the precise definition of taxable land value? Quantitatively, how much improvement in the efficiency of land use can be expected over time? To what extent will imperfect, but still good, administration vitiate the efficiency properties of the tax? In practice, how would a change to land value taxation change or redistribute land uses? How much delay in approaching efficiency can be expected from the existence of long-lived buildings on most urban land?

Also, how would land value taxation interact with land use regulation? One can imagine both complementarity and substitution. What other kinds of taxes or fees are most compatible with land value taxation, that is, would not undo the positive effects of land value taxation? This last question directly concerns the widespread use of so-called impact fees in many parts of the country.

There is little research extant that addresses any of these questions. The empirical research noted above on the impact of land value taxation deals with the question of whether additional investment is elicited by a switch to land value taxation, not with efficiency per se.

3) The Distribution of Income and Wealth

George attracted many followers with the proposition that land value taxation would alleviate poverty and the unequal access to economic resources. Economic theory and even superficial observation suggest that this must be so: poor people are not the important owners of land and other natural opportunities. The illiquidity of such assets and the need for access to large amounts of relatively low-interest credit would guarantee the result. But how much is this so, in our world, where two-thirds of households are owners of the urban land under their houses and people of moderate means have substantial ownership, albeit indirect, of corporate assets, including land and other natural opportunities? To the extent that the proposition is true (that the poor own few assets), a shift from a relatively proportional national tax system to land value taxation (if it amounted to a non-trivial fraction of total tax revenue) would make the distribution of tax burdens by income class more progressive.

Another set of questions is how land value taxation would affect the distribution of income and wealth among groups of households measured by characteristics other than income--age, homeownership, and so on. For example, it seems likely that a quantitatively significant amount of land value taxation would reverse the long trend toward relatively low tax burdens on older people.

The answers to these questions call for systematic and logically consistent tracing of the potential impacts. Data on land ownership are anything but explicit, so this effort entails piecing together data to make plausible estimates about the ownership of land and the income and wealth distribution of those owners. And having made such estimates, we need to compare them with estimates of the incidence of the major existing tax sources.

4) Relevance and Feasibility of Land Value Taxation in Rich Countries

The fundamental questions about the efficiency and equity of land value taxation may be answered positively, as they have been over the years, and in convincing quantitative terms, without being any more persuasive than has been the case in the past. Practical policy-makers generally seem to believe that land value taxation is not only politically poisonous, but also irrelevant to current tax policy and administratively infeasible.

As a policy matter, "relevance" means first, whether land value taxation has sufficient revenue potential to be a serious substitute for other sources of revenue and, second, whether it meets the revenue needs of different levels of government. (It has ordinarily been proposed as a local government tax in rich countries.) "Feasibility" involves questions of administrative capabilities. In the few rich countries in which there is substantial use of the conventional property tax as a source of local government finance, notably the U.S., Canada, Japan, and, to some extent, the U.K., the policy question often is posed as conversion of the conventional property tax into one on land only. Feasibility is less in question in such countries, although the administrative issues are far from trivial. In other rich countries, in which there is little or no use of the conventional property tax, the land value tax may be both relevant and feasible, but there is more argument about that. However, even m such countries, there is a lively interest in decentralization, and some forms of "recurring taxes on immovable property" (the OEGD term for property taxes) are often suggested as instruments of local fiscal autonomy. (5)

Many poor countries, especially those in transition from Communist systems, also have a lively interest in decentralizing government and, in some countries, in using property-tax-like fiscal institutions that are often rudimentary, but sometimes quite sophisticated. The question of relevance and feasibility in poor countries is noted below. But there are a number of reasons why there is a great deal to be learned from inquiring about the question in the rich-country context, for the following reasons.

- National tax systems have been in place for some time without major changes in nearly all rich countries: in Europe, for twenty years or more; in Japan, North America, Australia, and New Zealand for even longer. Therefore, there is a bias against radical changes, at least in political terms, which is often not the case in developing and transitional countries. So, skeptics might argue that land value taxation has little policy relevance for the rich countries.

- The efficiency costs of the existing tax systems are fairly well understood, and the efficiency gains from moving to the superior tax instrument, land value taxation, can be estimated with some confidence. For example, Martin Feldstein recently estimated that the economic losses to the American economy from an increase in the overall level of taxation (presumably, a proportional increase in all major tax sources) may equal as much as 165 percent of the additional revenue collected (Feldstein 1997, 210-11). (6) Nicolaus Tideman has estimated that, if Feldstein's estimate of the marginal economic cost of public funds is correct, the average economic cost is probably 45 percent of the total revenue collected (Tideman 1997). Thus, a major shift to land value taxation, which has no efficiency costs, would reduce the efficiency losses of the tax system by more than 45 percent of the amount of the shift.

- The effects of tax policy choices on the distribution of income and wealth has been a central concern in these countries for a very long time, certainly for as long as representative political institutions have been important. The advent of relative affluence, notably in the past fifty years, has made all these countries social-democratic to some extent; one aspect of this ideological transformation is widespread agreement that tax policy should be shaped to attempt some redistribution, even at some cost in economic efficiency. Redistributive land value taxation would be highly relevant to rich democratic countries, if their voters were persuaded that land value taxation is in fact appropriately redistributive.

- Land value taxation seems more feasible in rich countries than in poor ones, because the former generally have decent tax administration, which makes a sophisticated new tax relatively easy to implement. The quality of tax administration varies considerably among the rich countries and in some countries is far from matching best practice, but the situation is far better than in most countries in the Second and Third Worlds.

- Another dimension of feasibility is the presence and quality of legal and administrative machinery for establishing and recording land ownership, rights in land, and transactions in land rights. Once again, the rich countries, whether they operate under common or civil law systems, have land registration systems that work reasonably well. This is true of some poorer countries, but by no means all of them.

- Where there are existing real property taxes in use in the rich countries, those tax instruments--albeit highiy imperfect in every such country--usually are serious, functioning ones. That is far from the case with existing land taxes in nearly all formerly Communist countries and most developing countries.

- Local government has varying degrees of fiscal importance in the rich countries, but is real and functioning in most of them. That is not true at all in many of the poor countries. This has to do with the issue of relevance, because of the strong case that can be made for land value taxation as the ideal local tax.

Although the efficiency gains of land value taxation can be achieved by any tax on owners of land (if the amount does not depend on how the land is used or any other actions by the owner), the equity gains are lost if a measure that does not reflect the relative personal wealth of the owner in terms of land is employed. So, we can say that the feasibility of land value taxation is likely to be greatest in countries that already have in place:

1. a serious (that is, non-trivial in amount) tax on the real value of property, and

2. the valuations made for this tax are, at least in intent, based on the current market value of real property, because there is little doubt that there is a strong positive correlation between the ownership of valuable land and the income and wealth of the owners of land.

So, the relative importance and nature of property taxation are important variables in considering feasibility. As for relevance, the importance of local infrastructure improvements and service levels in determining relative land values, as well as the historic association between property taxation and local government, suggests that land value taxation is likely to be most relevant where:

1. local governments are responsible for provision of most local infrastructure improvements and local services and have a good deal of discretion in making decisions about such expenditure, and

2. local governments with average economic capacity (7) must finance much of their expenditure from revenue they themselves generate, again with some discretion in how they do so.

What are the differences in fiscal structure that are used in the 23 "rich" OECD countries (OECD 1996)? (8) We start with the extent of centralization in the tax systems of these countries in 1994. In 18 of the 23 countries, the central government together with the social security systems accounted for 70 percent or more of the total tax revenue, in numerous cases more than 90 percent. Among the five decentralized "sports," three (Canada, Switzerland, and the U.S.) are federal in their formal structures, and two (Sweden and Denmark) are unitary. The three other federal countries (Australia, Austria, and Germany) are significantly less decentralized in their revenue systems than is true of the other federal countries. Some countries, like Belgium, Italy, and the Netherlands, in which there have been professions of interest in devolution, remain only trivially decentralized on the revenue side. The U.K. is now the most centralized among the middle-sized rich countries, after a long history in which it was among the least centralized.

There is no obvious explanatory factor for these differences, aside from the idiosyncratic political history of each country. The smaller countries in land area tend to be relatively centralized, but Switzerland and Denmark are among the smaller countries and quite decentralized. There is no visual or statistical relation between the size of the public sector and the extent of its centralization, although one can posit a plausible hypothesis that suggests that a larger public sector should be more decentralized, and another to the opposite effect. One might argue that, because decentralization of revenue systems probably is more costly administratively than centralization and surely will yield inter-area disparities in revenues, decentralization is a luxury for the richest among countries, but that hypothesis, too, is inconsistent with the data.

As might be expected, in some countries in which local governments are of minimal importance, central governments also make minimal efforts to collect and report data on the finances of local governments, so the OECD documents contain obsolete (or no) data on the nontax revenues and grants received by local governments for eight of the twenty-three countries. For the other fifteen, it is possible to put together a more complete picture of local government finances, in order to understand how land value taxation might be relevant.

Just how important are the revenue collection authority and responsibilities of subnational governments--including their financing by user charges and other nontax revenues--relative to the size of their economies? Own-source revenues of provincial and municipal governments combined are more than 10 percent of

GDP in eight of the fifteen countries: three of the Nordic countries and all five of the federal countries. But local (municipal) government, by itself, does not reach the 10 percent level in any of the federal countries and is essentially trivial in Australia, where it amounts to about 2 percent of GDP.

The explanation for this is, of course, twofold: first, the spending responsibilities assigned to local government are very modest to begin with in Australia and Belgium, for example; second, local government spending is financed by grants, overwhelmingly in Ireland, the Netherlands, and the U.K. (In the federal countries, most grants to local government usually come from the intermediate level of government: states or provinces.) In fact, in nine of the fifteen countries, local governments finance less than 30 percent of their direct expenditure. Among the sources of own-source revenue, the variation in the relative importance of nontax revenue is less than the variation for other sources. As for local taxes, property taxes exist in thirteen of the fifteen countries, but they are overshadowed by other types of local taxes in eight of the thirteen.

Local government own-source revenue from the property tax is above 25 percent only in Australia, Canada, Ireland, the U.K., and the U.S. But that may be a misleading indicator of the potential for the use of land value taxation to finance local government expenditure. A better indicator may be the share of total general government revenue spent by local government in recent years. That is, if land value taxation, rather than grants from higher levels of government, were the sole or main source of financing local government, what share of total government revenue (all levels combined) would it account for?

In thirteen of the fifteen countries (all but Australia and Belgium), local government consumes 20 percent or more of total general government revenue. Nine reach the 25 percent level, and six reach the 30 percent level. That suggests the possibility of anything but a trivial role for land value taxation in many of the rich countries.

This is a static picture. The federal countries aside, in nearly all of the other rich countries examined here, there has been serious interest in more devolution to subnational governments. The U.K., for example, is developing a modified form of federalism. (9) A relatively small role at present for local government in the provision of public services and/or a very small degree of local financing of local expenditures may be subject to major changes in some countries. Thus, there could be a place for land value taxation in the most unlikely of countries, such as Italy, where devolution until now has simply meant more state grants to local governments to do things that are not very important (and where there are truly spectacular opportunities for the recapture of the rent of land, as in the Centro Storico of the Venetian commune). Still, feasibility and relevance are surely greatest in the more devolved countries in which there is some use of property taxation.

Earlier, I referred to estimates of the efficiency losses stemming from existing tax systems. Properly speaking, those estimates are of losses in output and consumer satisfaction caused by perfectly legal tax avoidance, that is, changes in decisions made by consumers and producers in response to taxation. (10) But there are other "deadweight losses," costs that, for the most part, are not measured in the usual estimates of efficiency losses." These losses consist of administrative (collection) costs and compliance costs of taxpayers themselves.

The administrative costs to governments of collecting and enforcing the provisions of the tax law are generally not significant. In the U.S., such costs for income, payroll, and consumption taxes appear to be quite low as a percentage of the taxes actually collected, and that is the case in most of the other rich countries. There are some exceptions, however. Table 1 shows one of them: about one-half of all state governments permit vendors to deduct a specified percentage from the sales taxes they are obligated to remit to the state, as "compensation" for acting as tax collectors. That can increase administrative costs to as much as 4 percent of collections, which is not a small number.

Table 1 ESTIMATES OF THE COSTS OF TAX ADMINISTRATION, TAXPAYERS' COST OF COMPLIANCE, AND THE EXTENT OF TAX EVASION, FOR VARIOUS U.S. TAXES

Administrative costs:	
Percent of tax collections--	
U.S. individual income tax	0.6
State sales taxes	0.4-1.0
vendor compensation, in half of states	1.0-3.6
Taxpayers' compliance costs:	
Percent of taxes paid--	
U.S. individual income tax	9.0
State sales taxes	2.0-3.8
Tax evasion:	
Percent of legal liability not reported on tax returns ("tax gaps")--	
U.S. individual income tax	20.0
U.S. corporation income tax	22.7
State motor fuel taxes	6.5
State cigarette taxes	5.4
State sales taxes (but the mail order tax gap is estimated at 2.4 percent of total state sales tax collections)	<5.0
State compensating use taxes	40.3
Delinquency rate for reported state sales tax liability (i.e., liability reported, but tax not paid)	13.0

Source: Mikesell (1997) and Murray (1997)

In comparison to income and consumption taxes, property taxes are often considered to have high administrative costs, largely because the determination of tax liability--valuation of property--is done by the tax authorities, not self-reported and subject to verification by the authorities, as in the case of other taxes. (12) For example, in their 1994 survey, Joan Youngman and Jane Malm report that, in the Netherlands, the cost of valuation in municipalities with populations over 50,000 is more than 5 percent of tax collections. They also report a cost of valuation figure of roughly 2.5 percent in Britain, for a system of valuation that is mediocre in its results, to put it kindly.

In the U.S., at least in larger cities and counties, total administrative costs for property taxation have been considerably lower when tax administrators discover that strange innovation, the computer. For example, in New York City, such costs are less than one percent, despite an extremely heterogeneous tax base and a property tax law of unbelievable complexity.

Perhaps more important, valuation for land value taxation has to be vastly easier and cheaper than for conventional property tax. It is true that the location of every parcel of urban land is unique and, therefore, its value must differ a bit from that of adjacent parcels. But the differences are minimal, which is not the case for non-residential buildings. The historic charge, going back to Ely, that valuation for land value taxation must be more difficult than that of land and buildings taken together originates in the notion that the value of a parcel of urban land is the market value of the land and building taken together, less the depreciated replacement cost of the building. In fact, following that procedure is unlikely to result in a number that reflects site value accurately. In contrast, developing "contour maps" of site value per square foot or square meter from sales and demolition records is a simple process. (13)

It is also important to keep in mind that the quality of valuation for the existing property tax is not very good, even if we exclude the worst jurisdictions. A high standard of performance is considered to be a coefficient of dispersion of 20 percent of the median assessment-to-market-value ratio. (14) That would be considered an entirely unacceptable result from the standpoint of horizontal equity in income or sales tax administration.

Compliance costs are another dimension of tax efficiency. How much does compliance cost taxpayers? Taxpayer compliance costs are negligible in the aggregate for the existing property tax in the U.S. In some cities, owners of commercial buildings and apartments are required to file income and expense statements for each such property with the assessor. (15) There are some one-time costs where there are exemptions and abatements available, and there will be costs if the taxpayer payments during the year equal the tax levy for the year, because of payment of previous years' taxes. The point is that there is no practical way to evade taxes on real property. (16)

Together, the costs considered here--evasion, administration, and compliance--are massive for the major income and consumption taxes, about 30 percent for the federal income taxes and as much as 20 percent for state sales taxes, but perhaps less than 2 percent for land value taxation. Surely, this has a lot to do with the relevance of land value taxation.

However, because land value taxation in relatively pure form has never been implemented, it is not likely to be adopted in any rich country without some persuasive research into administrative and compliance issues. Realistic scenarios are needed about the likely consequences of adopting land value taxation in each country.

5) Relevance and Feasibility of Land Value Taxation in Developing and Transition (Formerly Communist) Countries

In many Third World countries, there is serious effort to substantially overhaul (and increase in importance) local governments and to provide them with revenue sources of their own. In a few cases, there are existing local property taxes. Sometimes, but not always, feasibility problems with land value taxation would be very great. The relevance, however, is obvious. Few of them can afford the very large efficiency losses that their existing tax systems probably cause. All need to minimize the regressivity of existing or likely tax instruments (that is, bad copies of those in use in rich countries).

The concern for a useful system of local government is, if anything, stronger in most of the "transition countries." The efficiency cost problem is especially severe in most of these countries, such as Russia, in which most of the goods-producing industries have been value-subtractors, not value-addors, for some years. Some seek to resurrect old systems of local government that may have had some utility in the past--in reality or in romantic imagination. (17) Others seek to create systems from scratch where they have never really existed, notoriously, in Russia, Belorussia, and Ukraine. Here, too, there is frequently interest in local reliance on some form of property taxation, which may already exist, though badly designed. This makes land value taxation relevant. In addition, there is often residual hostility to private ownership of land that could be overcome if the rent of land could be largely recaptured for public use. But the feasibility problems can be severe, at least during the extended periods when land markets are developing.

Numerous Western advisers have worked on these issues in the developing countries over the years and in the transition countries more recently. Their findings and the results of their policy recommendations for local government finance in developing countries are fairly persuasive. That is less the case in the post-Communist countries, where much of the technical advice urges those countries to replicate standard OECD country tax systems, and implement property tax systems that promise to be the antithesis of land value taxation. There is a lot more to be known about the likely problems and consequences of implementation of proper land value tax systems in these countries.

6) Consequences for the US. of Substantial Reliance on Land Value Taxation

Not since the works of Henry George has there been a systematic examination of what would happen to the U.S. economy as a whole if land value taxation were to substitute for other public revenue in most jurisdictions in the U.S. To examine this requires general equilibrium analysis for the entire economy of a scenario in which land value taxation is a major (though not exclusive) substitute for taxes on income, consumption, and capital. Unlike George's time, this is to be done in an era in which there is a lot of non-local government finance. The scenario I envisage is one in which land value taxation accounts for a significant (10 to 20 percent) share of all public sector revenue in the U.S., and the tax is either national or imposed everywhere at rates that are not wildly disparate. Also, it should be assumed for this analysis that only the U.S. and a few other countries impose the tax, while others are not using land value taxation. This would permit the analysis to take into account the openness of nation al economies. What might happen to the levels of capital formation, to aggregate incomes, to labor income?

This strikes me as a fairly straightforward analysis, albeit requiring the considerable oversimplification needed for computable general equilibrium models. It is almost impossible to argue the case for land value taxation if the analysis is not made.

7) Relative Merits of Land Value Taxation and Conventional State and Local Taxes

What are the local and national advantages of substituting land value taxation for other taxes? This needs to be determined in jurisdictions that rely heavily on consumption and income taxes: at the local level, particularly in large cities, and at the intermediate (state) level in most rich federal countries (including the U.S.). The substitution of land value taxes for local nonproperty taxes flies in the face of the advice of many American public finance experts, who strongly urge nonproperty taxes on the large cities and more generally. A shift by the state to this form of property taxation would reverse the major shift in state tax systems that took place sixty years ago. It seemed clear enough then, and for some decades afterward, in light of the dreadful (and seemingly unimprovable) quality of property tax administration and what we thought we knew about the economics of the property tax (notably its excise tax character at the local scale), that income and consumption taxes were the preferred alternat ives. Henry George and his followers always disputed that conclusion, and they may have been right. In light of current knowledge about the deadweight losses and administrative burdens of other taxes, was the negative view of the property tax ever valid?

8) Land Value Taxation as a Cure for a Variety of Additional Economic Ills

George made a persuasive case that, in the American economy of 1879, reliance on a single tax that recaptured all the rent of land would cure an array of economic ills, especially the business cycle. We think we now know how to avoid wild swings in the economy, collapse of the financial system, and prolonged depression by means that are relatively benign. We also recognize the incredible complexity of the economic world today. As a result, few see the business cycle as one of the gravest of our economic ills. But long-term growth is another question, and one that George was concerned with.

Today it is appropriate to ask what a switch to land value taxation can contribute to sustainable growth, thus including environmental concerns. It is appropriate in this connection to define the tax more broadly, as one on the return from exploitation of any scarce resources that are not the product of human endeavor, but that are appropriable by private parties. Some of the answers to the questions may be implicit in or suggested by the answers to the questions posed earlier in this paper, but some are not.

Conclusion

IN THIS PAPER, I have assumed that most people who attend a lecture named for Henry George are likely to be at least sympathetic to the ideas associated with him. I have not tried to make a positive case for land value taxation, which seemed superfluous. What I have attempted is to deal further with what has always seemed to me a great mystery: why, given the virtues of land value taxation, has there been so little success in persuading governments to adopt it? Some years ago, I propounded the notion that at least part of the explanation, as far as this country is concerned, can be found in the strong antipathy among ordinary Americans against taxing unrealized capital gains, which land value taxation does (Netzer 1984). (We economists see no problem with this, but then we see no case for minimum wages, or for heavy taxation of the income from capital, or for barriers to international trade, or for numerous other things that enjoy wide popular support.)

<> In this paper, I have taken a different tack, addressing what surely is a less emotional cause for reluctance to adopt land value taxation: uncertainty as to how it would really work out in practice in the contemporary world. I have listed what I see as the reasonable person's hesitations, in the form of questions that researchers should be able to answer. The answers still may not be persuasive politically, but I think that answers that are intrinsically valid can be found. A group of economists, under the sponsorship of the Lincoln Institute of Land Policy, are right now trying to find those answers.

Notes

(1.) Ely was a co-founder of the American Economic Association and of a long-lived school of policy-oriented University of Wisconsin economists who tended to minimize attention to economic theory.

(2.) Examples of "approximations" are a) taxes on increases in land value, b) land value tax rates that are so low that they can have no discernible effect on behavior, and c) parcel taxes, which are levied per unit of land rather per unit of land value.

(3.) There are dozens of articles on this subject in economics journals. A few of the more important articles contending that land value taxation distorts the timing of development are Shoup (1969), Shoup (1970), Skouras (1978), and Bentick (1979). Tideman (1982, 1995) critiques the non-neutrality thesis, arguing that the authors who take that position have analyzed a tax on the discounted future income of the planned use of a site, not a tax on the market value of the site, which is the value assessors aim to estimate. In an empirical test of the non-neutrality thesis comparing Wellington and Auckland, New Zealand, Roakes et al. (1994) find no evidence that land value taxation affects the timing of development.

(4.) Oates and Schwab (1997) is a good source for other empirical studies of Pennsylvania cities. Empirical studies of Australia are also available: Brown (1980) describes a study by Hutchinson (1963) that compared suburbs around Melbourne, which found those taxing land only (not buildings) had twice the value of residential improvements as those using a standard property tax. Edwards (1984) analyzed differences among tax jurisdictions in the Melbourne area with econometric models and found results similar to those of Hutchinson. By contrast, Lusht (1992a and 1992b) found little effect of land value taxation on housing construction around Melbourne, but a considerable effect on industrial development.

(5.) OECD stands for Organization for Economic Cooperation and Development. It consists of countries in Central and Western Europe and North America, plus Canada, Turkey, Japan, Korea, Australia, New Zealand, and Mexico.

(6.) Feldstein estimates that if all taxes (income tax, payroll tax, sales tax, property tax, etc.) were raised proportionally by enough to yield an additional (marginal) $100 of revenue, there would be a loss of private real income of not just $100 million, but an additional $165 million. This loss has three principal components: 1.) the loss of output from the fact that people would work less; 2.) plus the loss from a less efficient division of income between saving and consumption; 3.) minus the value of the additional leisure that people have because they work less. The loss from the first or middle $100 million of revenue is less than the last (marginal) $100 million, because when taxes are higher, people go to greater expense to avoid them. Thus the average cost of public funds ($45 per $100 in revenue) is considerably lower than the marginal cost.

(7.) The specification "average economic capacity" allows for a system of fiscal federalism in which the poorest places may receive so much in grants from higher levels of government that they do not in fact finance much of their spending from local taxes.

(8.) The OECD member countries excluded are the three recent Central European adherents (the Czech Republic, Hungary, and Poland) plus Mexico, and Turkey. The poorest member country included is Greece.

(9.) Scotland held a referendum on home rule in September 1997. Legislative bodies with specified responsibilities now exist in Scotland and Wales.

(10.) Tax avoidance affects decisions to invest, to work, and to save and choices made among inputs and consumption of goods and services.

(11.) A deadweight loss means costs not compensated by benefits, useful activities that would have taken place but did not, or activities that people must undertake that do not contribute to the total value of the economy's output of goods and services.

(12.) In the U.S., most states also subject non-real property in the form of business machinery and equipment and, less often, inventories, to property taxation. That is done on the basis of self-reporting, with minimal attempts at verification in almost all of the states. The result is that, in practice, the value subject to tax is rarely as much as 50 percent of the value that should be reported according to economic data.

(13.) Some writers have developed quite different methods of estimating land rents, but using methods that are quite expensive or entirely impracticable outside the pages of economics journals.

(14.) For those not familiar with the coefficient of dispersion, a simple example may clarify it. Suppose five houses have been sold in an area. The first one was assessed at $28,000, but it sold for $100,000. Thus, the assessment-to-market-value ratio for that house is 0.28. The ratios for the other four houses are 0.35, 0.40, 0.46, and 0.49. The median (middle) ratio is 0.40. The differences (treating negative numbers as positive) between the median and the other ratios are 0.12, 0.05, 0.06, and 0.09. The average of those differences (0.08) is their sum (0.32) divided by 4. The coefficient of dispersion is the average difference divided by the median (0.08 divided by 0.40), which is 0.2 or 20 percent.

(15.) For taxpayers who own only one such building, the marginal cost of compliance is the price of a postage stamp, since the appropriate federal income tax schedule is acceptable.

(16.) This is not true of personal property taxes, however.

(17.) I recall reading some 30-odd years ago in the leading Bogota newspaper one of a series of essays by an economist who was about to be inaugurated as President of the Republic. The central point of the essays was the proposition that the "genius" of Colombia lay in its 880 municipios. I had just calculated that 850 of them did not have enough revenue to provide any public services at all, beyond the salaries of the alcalde (mayor), municipal clerk, and municipal tax collector.

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