TESTIMONY ON ECONOMIC DEVELOPMENT

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(The following testimony was presented by Dr. Bill Batt, Center for the Study of Economics, December 17, 2012 to the New York State Legislature Committee on Economic Development.)

I am here to invite you to think outside the proverbial box, and look at ideas that stem largely from economic theory prior to the 20th century, that which prevailed from the era of Adam Smith until the birth of what is called neoclassical economics. With the collapse of much such thought, there is renewed exploration of ideas that have been moribund for a century. I began to look anew at much of this thought at the end of my service in the Legislative Tax Study Commission in the 1980s, especially given the advent of computer power and available data to explore and test these claims. Today we see endorsement and implementation of tax policies based on them worldwide; unfortunately New York is not yet interested or involved.

Most taxes discourage economic vitality—taxing sales reduces consumption; taxing wages discourages work; taxing interest reduces savings—and so on. There is one exception to the impact of taxation: taxing a base with an inelastic supply. Such taxes engender growth and economic vitality. Here the greater the tax the more the economic vitality. Recently Professor Joe Stiglitz has written that

> One of the general principles of taxation is that one should tax factors that are inelastic in supply, since there are no adverse supply side effects. Land does not disappear when it is taxed. Henry George, a great progressive of the late nineteenth century, argued, partly on this basis, for a land tax. It is ironic that rather than following this dictum, the United States has been doing just the opposite through its preferential treatment of capital gains.
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> But it is not just land that faces a low elasticity of supply. It is the case for other depletable natural resources. Subsidies might encourage the early discovery of some resource, but it does not increase the supply of the resource; that is largely a matter of nature. That is why it also makes sense, from an efficiency point of view, to tax natural resource rents at as close to 100% as possible.

If we taxed what are classically called "resource rents," they could totally supplant other revenues streams that are such anathema; in fact taxing rents is essentially painless. This is because their source is "the commons," socially created wealth that shouldn't be private in any case. Rent is the perfect tax base, as it comports with all the textbook principles of sound tax theory. A land value tax is completely neutral, totally efficient, highly progressive, easily administered, reliably stable, simple to understand, and impossible to avoid. Secondly, because rent that flows through site parcels is socially created value, there is sound moral ground for society to collect that which it has created. This then leaves to members of the community the full retention and ownership of their labor wages, as well as any products of their labor they are themselves responsible for creating. Thirdly, it reduces the "throughput" of natural resources that otherwise obtains due to the use of other tax regimes. With resource conservation in mind, a tax on ground rent fosters efficient land use configurations. The centrifugal forces of sprawl development are reversed, just as excessive reliance upon transportation from one place to another, and thereby consuming inordinate quantities of natural resources, materials and time.

The failure to tax rents leads to its private capture, a practice labeled "rent-seeking," One textbook describes it as "competition for privilege. The form of government affects the extent of rent seeking that takes place... in general, whenever personal benefits depend on decisions made by other people, life can become a quest for personal favors, and people spend time and effort in rent-seeking activity." Another calls it "the use of resources to get a rent by reducing the welfare of others." It is really a form of stealing what is rightfully part of the commons.

Only in recent decades has rent and rent-seeking been restored to economic discourse. The story of its extirpation is just now being told, of an academic putsch by powerful industries a century ago bent on capturing common wealth. It is arguably the greatest instance of venality in world history. Today's economics textbooks trivialize and even hide the amount of rent as an element of the nation's economy, typically putting it as about one percent of GDP. Those numbers come from our own government's accounts, which ignore or hide several kinds of rent such as that imputed to owner-occupied homes, and that which is accrues by capital gains transactions. Stiglitz' most recent book explains that this hidden rent is the source of income for the elite of America. It is not earned at all; William Gladstone called it "lazy income."

The amount of resource rent flow is now known as the "Henry George Theorem," and several Nobel Prize-winning economists have worked out its dimensions. It has its roots in a claim made by Henry George in 1879, that

> In every civilized country, even the newest, the value of the land taken as a whole is sufficient to bear the entire expenses of government. In the better-developed countries it is much more than sufficient. Hence it will not be enough merely to place all taxes upon the value of land. It will be necessary, where rent exceeds the present government revenues, commensurately to increase the amount demanded in taxation, and to continue this increase as society progresses and rent advances.

I have been working on matters related to the Henry George Theorem for about five years. Three years ago I brought back into print a book originally published in 1946 by a local self-taught Albany adherent of Georgist thought, Gilbert Tucker. Tucker received little recognition for his observation at that time. But he was very clear. He begins his book The Self-Supporting City with the following statement:

> Municipal taxation as now levied can and should be a thing of the past: the American city can be a self-supporting corporation, meeting its expenses

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> from its rightful income. Taxation is unnecessary, because the city has, in its physical properties, acquired through the years, by the expenditure of its people's moneys, a huge capital investment from which it collects only a very small part of the return earned.

It took about three decades, until the 1970s, for leading figures of the economics profession, primarily William Vickrey and Joseph Stiglitz, to rediscover the idea and give it a name. Stiglitz's conclusion after doing some heavy-duty mathematics was that

> Not only was Henry George correct that a tax on land is non-distortionary, but, in an equalitarian society, in which we could choose our population optimally, the tax on land raises just enough revenue to finance the (optimally chosen) level of government expenditures.

Today, the basic thesis is part of the canon of economics and public finance. With the many resource rents now identified that George never knew about, rent as a proportion of GDP is easily high enough to support the public sector. One should note that in Australia, where books are kept a bit differently, economic rent has been calculated at upwards of thirty percent.

> The 'bottom line' reinforces the overall conclusion ...that land-based tax revenues are indeed sufficient to allow total abolition of company and personal income tax. Further, to the extent that some taxes, such as rates, land tax, resource rent taxes and even part of income tax on land rents are already capitalized in lower market values for privately held land, the figures would tend to understate the capacity of land income to replace existing taxes.

Why it is so difficult to measure in the US becomes clear by the following explanation. One needs to understand that all revenue streams are ultimately shifted to ground rent. Put differently, whatever rent is identifiable as such is always net of taxes paid, and that all taxes in the final analysis come out of land rent. To land economists, this has been abbreviated by the acronym ATCOR: All Taxes Come Out of Rent. The claim that governments must rely on multiple tax regimes—sales, income, and property, for example—and should ideally be balanced so as to form the proverbial "three legged stool" is without foundation, and reflects a lack of understanding of how tax burdens are passed through the society—called "tax incidence."

But if all taxes ultimately come out of rent, what difference does it make from which factor of production a tax is levied on? The answers have been amply shown. When other factors of production are taxed, there are several downside effects, especially by what is called "deadweight loss." Taxing land rent is free from all such pitfalls. These are not insignificant. Harvard economist Martin Feldstein figures the deadweight loss of the income tax to be about thirty percent of the before-tax income and fifty percent of after-tax income if Social Security included. Taxes on the sale of goods appear to have comparable effects. Other studies show the total productivity loss of our existing tax structure to be about a tenth of total GDP. Put differently, if taxes didn't damp economic productivity, we'd all be about ten percent wealthier as a society. There are also other detrimental features of taxes imposed on labor and capital goods.

But taxes on land value have no deadweight loss whatsoever; they comport moreover with all the textbook principles of sound economic theory enumerated since the time of Adam Smith. Taxes on rents from natural resources are the perfect tax. They don't influence market choices. They are easily collected and impossible to evade. They are commensurate with one's ability to pay, and they are easily visible for all to see. We could, if we only would, tax only the rental value of such resources and have sufficient revenue to support all government services, and then abolish taxes on people's labor and all the products of their labor. What people earn is theirs to keep! Substituting community created ground rent for those other noxious taxes would be far more defensible as a revenue source. Again, the community would recapture that which has been collectively created by the community.

Our conventional property tax is really two different taxes to an economist: one on land value and one on improvement value. Taxing improvements is just dumb—it penalizes those who develop and maintain their property in good order. Buildings depreciate just like cars and computers, by one study at about 1.5% yearly. So any appreciation in property is due mostly to increases in land value. The capitalized market value of land sites reflects the unrecovered flow of rent in public taxes. By untaxing or capping the property tax we shift its flow to a capitalized form and remove it from circulation. That wealth is then frozen. But by taxing it that wealth can be made liquid and returned to circulate through the economy. The total worth of any land site is a function of its rent flow, as well as the part which is capitalized, the part which is taxed as rent, and any other encumbrances or obligations that the titleholder bears. One cannot avoid locational rent because its volume reflects the economic vitality of the very community that creates it.

The conventional property tax part on improvements penalizes the titleholder who fixes up his site and then has to pay a higher tax, and rewards the one that lets his holdings go to wrack and ruin. Most of all, it rewards the land speculator of vacant parcels, whose market values often appreciate faster than any tax burden takes away. The tax on the land value generates activity; the tax on improvements discourages it. So the property tax is like a train with an engine on both ends, each one negating the effects of the other. Some two years ago, this line of thinking prompted a research fellow at the New America Foundation to ask, "What if the problem isn't the property tax at all but rather, well, all other taxes?" His ability to think freshly about tax policy may be due to his having studied broadly on policy (continued on page 14)

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matters rather than being steeped in neoclassical economics alone. As he explained it to the Atlantic Magazine in an outside-the-box list of "15 Ways to Fix the World," "the Single Tax [has merit] not least because it creates the right incentives for government. Simply put, the better you govern, the more valuable the property. The more valuable the property, the more revenue you raise."

Here in New York, we are doing just the opposite of what we should be. We're shifting tax burdens off land rent and increasing the burdens on wages and goods. For titleholders unduly burdened by the institution of a land value tax regime, there are ways to address such problems, something for a longer discussion, and which I have testified about at other times. We should recognize, however, that students of tax policy elsewhere have begun to explore these ideas very diligently, especially in the UK. I should add lastly that this approach cuts totally across traditional party lines: in the UK, proponents include LibDem Cabinet Minister Vince Cable, rising Tory star Nick Boles, and Labour shadow Minister Andy Burnham. There are many studies done recently, and MP Caroline Lucas has just introduced a bill that would authorize a major feasibility study this year. Martin Wolf and Philip Inman, two of Britain's most respected columnists, are both supporters as well. And it's not just English speaking nations: I myself am on my way to Asia to talk in Korea and Thailand this coming February. We would do well to include proponents of these ideas in any discourse on tax policy here in New York as well.

At one time these ideas were widely understood. A century ago, Henry George's name was known as well as Thomas Edison and Mark Twain. His book Progress and Poverty sold more copies than any book ever published except the Bible. With the power we now have to run the numbers, we should be doing this. But it will take leaders with the open-mindedness to ask staffers sadly educated in the conventional neoclassical mold to carry out the research called for. We should not be the last to recognize that thinking is changing as we deliberate. Several new books and articles are now issuing yearly.

(Dr. Bill Batt may be emailed at hwbatt@yahoo.com. GroundSwell does not have space for footnotes, but they are available from Dr. Batt.)

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