RIGHT-SIZING TAX TALK

By Bill Batt, Albany, NY

Promises of cutting taxes are all the rage this year, even when candidates aren't willing to indicate where comparable budget cuts can be done. The greatest amount of resentment seems to be directed toward the real property tax, although that's the one that is least understood of all.

Theorists of tax policy use criteria to evaluate which taxes are best and which are worst, and they are typically found in graduate school textbooks on public finance. Unfortunately, little effort is made to help public officials understand them. A good tax should be measured by as few as four criteria or as many as eight, depending on how the measures are described.

A good tax is efficient -- it rests lightly on the economy without deadening its vitality, neutral inasmuch as it imposes no distortions on market choices, and fair insofar as people pay according to the comparability of their situations. It is also easily administered with low costs, simple for people to understand, and reliably stable to the extent that the public can depend on the revenue stream for support of services.

Economists and tax officials use terms like shifting incidence, deadweight loss, excess burden, tax expenditures, moral hazard, and capitalization, all of which are terms applied to the criteria noted above. Yet tax theory rests on economic theory, and the economics that has prevailed for the past century now appears flawed. One consequence is that all the taxes that are reviewed by contemporary conventional economists are deemed to have downside effects and that there is no "perfect tax."

Applying classical economic theory, the economic paradigm that obtained prior to 20th century neoclassical economics, offers answers that are outside the realm of mainstream consideration today. Classical economics recognizes the significance of rent, also called ground rent, land rent, or economic rent, whereas neoclassical economics trivializes it. Rent, as used by political economists from Adam Smith, Thomas Malthus, David Ricardo, John Stuart Mill, Henry George and Alfred Marshall, meant "income derived from the free gifts of nature." In Wealth of Nations, Smith wrote "Both ground-rents and the ordinary rent of land are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. Though a part of this revenue should be taken from him in order to defray the expenses of the state, no discouragement will thereby be given to any sort of industry....Ground-rents and the ordinary rent of land are, therefore, perhaps, the species of revenue which can best bear to have a peculiar tax imposed upon them." Mill added the observation that "Landlords grow rich in their sleep without working, risking or economizing. The increase in the value of land, arising as it does from the efforts of an entire community, should belong to the community and not the individual who might hold title." It was left to Henry George to synthesize what had come before and write that "we may, without jar or shock, assert the common right to land by appropriating rent by taxation."

Because land rents from natural resources are socially created values, and constitute windfall gains to titleholders when not taxed, they actually improve the performance efficiency of the economy when they are removed to support public services. Taxing rents in no way inhibits or distorts economic vitality, and conform in every other way to the principles of sound tax theory. In fact, unlike other taxes, a tax on land value actually fosters economic development rather than being a leaden weight. This is because it frees up investment that otherwise constitutes "frozen capital," and makes available on the market sites that are otherwise held for speculative gain.

Because land has a fixed supply, the incidence of tax burden cannot be passed forward, which means that it is paid by those who own land sites with the highest market value. A land value tax falls largely on urban sites in core areas. It is easily administered, unavoidable, simple to understand, and highly stable. George wrote 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," a thesis today known as the Henry George Theorem, and borne out in studies by leading economists including Nobel laureates William Vickrey and Joseph Stiglitz.

By law assessors must value land sites separately from improvements, and computer technology now provides the means by which to do this quickly and cheaply. It is a simple procedure to alter the conventional property tax by phasing out the tax on the building component and securing the same revenue stream by taxing land value alone. The gains in efficiency and resulting economic performance are amply demonstrated in the many localities worldwide where this tax regime has been instituted. Objections to taxing the rental flows from land sites fall apart when the economic dynamics are fully understood.

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