LETTER FROM THE F.B. HERON FOUNDATION – SOME COMMENTS TO CONSIDER

Posted by Edward Dodson, Cherry Hill, NJ, edod08034@comcast.net, July 15, 2015

(Ed Dodson of a listserv of senior officers of community banks and credit unions. One of the subscribersis a member posted comments by his organization, the F.B. Heron Foundation, which is based in New York City and is focused on solving social problems. Ed posted comments on July 15, 2015 as interspersed below to info@givingstrong.com; cdbl@ofn.org.)

The F.B. Heron Foundation has provided us with some food for thought. I am sure many of us are sympathetic to the plight of so many of our fellow citizens. There is little agreement even among thoughtful people of what should be done to address the unresolved problems of generational poverty, long-term unemployment and the concentration of wealth and income in the hands of fewer and fewer people and entities.

Simple observations confirms that the version of supply-side economic policies embraced by Ronald Reagan and self-described conservatives have accelerated the concentrations of wealth and income in the United States. The financial rewards have over three decades dramatically shifted from those coming from wealth production in favor of "rent-seeking" strategies identified by economist Joseph Stiglitz.

> "Reagan argued that decreasing the tax burden for the rich-investors, executives, corporations and the like, would not only increase their own income but stimulate broad economic growth as they create opportunities for others' increased prosperity. This belief has been at the center of conservative economic thought in the United States and abroad since Reagan's presidency, during which he cut tax rates for the rich."

What the Reagan version of supply-side economics ignores is the very different effects taxation or the absence of taxation has on different classes of income and assets. These distinctions were understood by Adam Smith and most other political economists but have been ignored by most economists. Smith had an explanation for the attitudes described here:

> "I see the decadence of the people in Rancho Santa Fe [Calif.] as a microcosm of America today, particularly corporate America. What these people exhibit, apart from their smugness, is a complete absence of any sense of collective responsibility. They can't see and aren't interested in the consequences of their actions. And they can't muster a modicum of moderation in the face of enormous scarcity. Every resource, every (continued on page 5)

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privilege, is theirs to pilfer with impunity. These people are prepared to endanger an entire ecosystem simply to avoid the indignity of brown golf courses; this is what true entitlement looks like."

Adam Smith would have seen this as problem of public policy. Wasteful activities are subsidized by under-taxation of land (and land-like assets, such as the broadcast spectrum) and over-taxation of incomes earned by producing goods or delivering needed services. Adam Smith did not use the term "rent-seeking" but he understood that the rental value of land has everything to do with the aggregate need for land, as well as our societal investment in infrastructure and amenities. He argued that these societally-created values should be taxed accordingly. This is exactly the policy advocated by Joseph Stiglitz (and, one might be surprised to learn, by Milton Friedman years ago).

Take the reference to golf courses constructed in arid places:

> "Entitlement has many faces, the most destructive of which is on display in Rancho Santa Fe. These adolescent upper-crusters are entitled because they believe they have a right to everything they can get hold of - regardless of the costs. They believe living with others carries no obligations. Anyone who places their right to pristine golf courses above their responsibility to respect communal resources is a social toxin, a privileged parasite eating away at the foundations of society. It's important that their actions be seen in this context."

The value of arid land (absent below-ground resources) will normally be quite low. What gives this land its value is access to water at subsidized cost. The land increases in its dollar value based on the net imputed rental value created by irrigation. Laws that grant monopolistic control over water going back to the 19th century result in high costs to residential users and wasteful usage by those who hold these legal (rent-seeking) claims to a natural resource they did not produce. An annual tax on irrigated land equal to its potential rental value would lead to far more efficient use of water and bring down the cost of land for everyone who needs it The path to addressing "income inequality" must go through serious changes in how government at all levels raises needed revenue. The right approach has little to do with how "we can do it without affecting the rich." What is most important is how individuals acquire income and wealth.

> "[I]f reducing inequality is the goal, there's simply no alternative to slowing the income growth of the highest earners by, say, raising upper-income tax rates or limiting the favorable tax treatment of pay for corporate executives -- a point a variety of economists, like Joseph Stiglitz, have made of late."

The devil is in the details. A truly progressive form of income taxation would help. We could combine progressivity with tax simplification by exempting all individual incomes up to, say, the national median. That would be the only exemption. No other deductions would be permitted. Then, above the national median, begin to impose increasing rates of taxation on higher ranges of income. At the higher levels of income more and more income is derived from passive investment and from speculation than from producing goods or delivering services. Also, as there is really no such thing as a "capital gain" (because real capital goods depreciate over time down to zero or scrap value), income from the sale of any asset would be added to total income and taxed accordingly.

This is not a perfect solution to the problem, however. The exemption of individual incomes of most working people from taxation will result in an increase in land prices. Whenever the demand side of the equation is expanded, the window of affordability quickly closes. Income gains are capitalized into higher land prices. To counter this, local governments (including school districts) must restructure the property tax to exempt property improvements from the base and move to tax land holdings as close as possible to the full potential annual rental value of land based on its highest, best use.

> "If foundations really did focus far more general support on fewer organizations, they would need fewer staff and could be smaller institutions. And so Walker's vision threatens the livelihoods of a great many philanthropoids who now lead busy and important lives making program grants to myriad non-profits."

An interesting observation. The size of the "middle class" in the United States is very directly related to the growth in public sector employment and the growth in the non-profit sector. Government growth has been accompanied by increased taxation that imposes serious "dead weight losses" on economic growth (meaning, the wrong incomes and assets are taxed, as noted above). While the non-profit sector channels funds back into the economy to mitigate societal problems, a high proportion of the income is derived from rent-seeking forms of speculation-driven investment.

If the board of trustees at the Ford Foundation and other foundations want to attack poverty and inequality at its "roots," they need to work to restructure our dysfunctional land markets by calling for the above reforms in how government raises its revenue. In the interim, they could establish a program of land acquisition under which land would be offered to private individuals and entities at full market land rents, then turn over the rents to local government as a payment in lieu of property taxes, provided the local governments exempt the value of all property improvements
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constructed within the foundation's land holdings.

> "At a recent event, President Obama discussed his administration's recent decision to revise overtime rules so that people getting paid up to $50,400 a year would qualify for overtime. The proposal aims to combat the practice of certain employers who promote employees to a titled position, raise their salary marginally, and avoid paying them for extra hours."

Here comes the most powerful law associated with economic policy: the law of unforeseen consequences. Increase the incomes of these individuals without increasing the supply of affordable housing units in an area and the cost of leasing an apartment will rise, as will the cost of residential housing generally. This is our land market at work. The same thing occurs when mortgage interest rates fall; the increased affordability is capitalized into higher land prices reflecting the fact that a buyer can carry much higher mortgage debt at 4% than at 8%. So, workers may gain in nominal income but to find affordable housing may have to seek housing more distant from their work location, incurring higher commuting costs and having even less time to spend with family or be involved in community affairs.

This is confirmed below:

> "During the broader recovery, the jobs have been created in the same metro areas where housing is relatively scarce -- Boston; San Francisco; Washington, D.C.; Seattle," said Stan Humphries, chief economist at Zillow, a real estate website. "That's inflamed rent appreciation."

According to the housing center's report, the share of renters paying more than 30 percent of their income on rent -- defined as "cost burdened" -- has held at near-record highs. In 2013, almost half of all renters fell into that category. The share of cost-burdened renters is growing among people with moderate incomes, those who earn from $30,000 to $75,000 a year, the report said.

The conditions described in this letter by the F.B. Heron Foundation will only get worse without systemic changes. As Joseph Stiglitz and a small number of other economists are warning, the boom-to-bust cycle driven by our property markets is again well underway. Without decisive action taken soon the next crash could be far worse than what we experienced in 2008

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