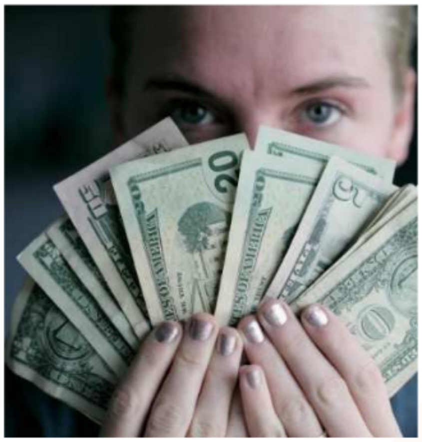
INFORMED PERSPECTIVES

VIEWS ON OUR WORLD, THROUGH A GEORGIST LENS

THE PERFECT IS THE ENEMY OF THE GOOD, EVEN WHEN IT COMES TO RAISING PUBLIC REVENUE



BY EDWARD J. DODSON

As Americans contemplate whether and how to exercise their vote in this year's elections, they have numerous important issues to consider. One vital issue is what, if any, legislative changes will the newly-elected Federal, State and even Local governments pursue with regard to much-needed public revenue. We may be certain already that Republicans are not likely to reverse their policies on current low rates of taxation. Republican claims that economic growth would yield more public revenue have not proved true. Statista.com forecasts a gross Federal debt of 23.522 trillion dollars by the end of 2020.

Progressive Democrats and proponents of democratic socialism argue that the high concentration of income and wealth among a very few people in the United States is as much a crisis of moral principle as it is the source of economic instability throughout the country. They are correct in their contention that real and progressive tax reform is needed; a reform that would combine simplification of compliance with progressive policy and implementation.

However, Progressives pay very little attention to the distinction between income that is *earned* versus income that is *derived* from a passive investment, speculation, or *rent-seeking* privileges. One of the candidates for President in 2020, Joe Biden, proposes that capital gains be taxed as ordinary income for those earning more than $1 million. Well, this proposal is at least headed in the right direction. But what might real tax reform look like?

Individual Income Tax

A first reform would be: exempt all individual incomes up to some amount (e.g., the Federal median income, and double this amount for households with two adults filing jointly). All other exemptions and...(cont'd on pg. 5)

WHAT HAPPENED TO THE FREEDOM DIVIDEND?

BY MATTHEW DOWNHOUR

Although he failed to garner any delegates and has suspended his campaign, Andrew Yang ran perhaps the most remarkable campaign of the primary. Despite having no political experience, and without a massive personal fortune to self-fund with, Yang managed to build a high enthusiasm campaign that qualified for most of the debates and performed better than many better-known candidates. His was also close to a single issue campaign – the centerpiece of his platform was a guaranteed monthly payment to every citizen, called the 'Freedom Dividend'.

The idea of an 'unconditional basic income' – a government payment to each individual made in cash with no strings attached - has been touted by a variety of thinkers for centuries, dating at least to Thomas Paine's 'Agrarian Justice', a pamphlet published during the French Revolution, and has taken a variety of forms. Yang's campaign, legions of online followers, and his debate appearances have brought new attention to the idea, and particularly his iteration of it.

This Dividend, the argument goes, could replace many current means-tested cash benefits – while that would mean distributing some

cash to people who don't really need it, it would also clear much of the paperwork and stigma that accompany means tested programs, and eliminate the 'welfare traps' that form a strong disincentive to individuals receiving welfare benefits to increase their earned income.

There are numerous criticisms of such a proposal, from both right wing and Marxist perspectives. Conservatives complain that the 'free money' amounts to a redistribution of earned income, while Marxists worry that it will actually diminish class consciousness and delay real structural change. Both sides have argued that it will lead to fewer people working if they have reliable non-work income.

The validity of these complaints depends on one's perspective; however, one concern in particular touches very closely on an underdiscussed economic principle, but sadly...(cont'd on pg. 5)

The Perfect is the Enemy of the Good, Even When it Comes to Raising Public Revenue (cont'd from pg. 4)

deductions would be eliminated. This reform would address the inequity of the current system with regard to income, and in which taxed gains on asset sales are treated more favorably than income earned as wages.

A second reform would be: above the exempt level, impose an increasing rate of taxation on higher ranges of income. The rates and ranges would be set during the budgeting process, with the objective of raising some portion of total revenue required to balance the budget. State Governments would be encouraged to adopt the same basic structure. The amount of revenue raised by the states versus the Federal Government would then play a role in policy decisions about revenue sharing. Potentially, states would no longer depend on Federal revenue to balance their budgets, and, in turn, Federal spending could be adjusted downward.

Inheritance or Estate Tax

Again, the system should be simple and progressive; meaning: exempt some levels of estate value from taxation. The median amount of individual estates is at this time still rather low, particularly when equity in a residential property is not considered. At the beginning of 2019, this median amount was just $97,300.

A suggested exempt level is $3 million, which is high enough to respond to any concerns that family farms would be negatively impacted. Above this exemption level, as with the individual income tax, increasing rates would be imposed on higher levels of inherited assets.

Local Property Taxes

What do communities provide to individuals and private entities? They offer locations for the use of public goods and services. Every parcel or tract of land has some potential annual rental value, a value that has little to do with what an individual owner does or does not do with the location where this land is held. This rental value rightfully belongs to the community as a whole, and this collective value needs to be determined and collected through taxation. However, at the same time, buildings are produced by private individuals or entities. The annual tax on buildings is equivalent to the imposition of a sales tax like the tax imposed on other goods annually. A building is a depreciating asset, much the same as an automobile or machinery. A building remains useful only because owners perform regular maintenance and replace roofs, heating and air-conditioning equipment, plumbing and other systems as they wear out or break. Taxing the building adds to the cost of the upkeep necessary to prevent its condition from deteriorating or even becoming unusable over time...(cont'd on pg. 6)

What Happened to the Freedom Dividend UBI Rent (cont'd from pg. 4)

misunderstands it. That is the fear that a $1000 UBI will lead immediately to a $1000 increase in rent. Two economists, David Ricardo and Henry George, are helpful in understanding why this at first seems like a valid concern, why this argument is overly simplistic, and what the actual shortcomings of a UBI would be with respect to land.

First, there is a certain level of sophistication in the argument, as applied directly to rent. Spending on rent is different than spending on other goods. Take spending on cars – if Ford decided to raise the price of all their cars to try to soak up the additional income from a UBI, very quickly Toyota would undercut their new prices to gain market share, so they are constrained in the short run.

These constraints also apply to the long run - if every consumer in the market were willing to spend more on cars, the market would respond by bringing new factories online or even whole new firms opening up, so that the price eventually settled into something close to its original equilibrium in the long run. Whether the price goes back down to its original equilibrium depends on the exact market, but what is clear is that the increase in prices will not completely negate the impact of the UBI, and indeed will probably have little impact on it.

Renting a building or a room is similar – as the rent rises, the rate of return on building construction rises and more firms will build apartments, counteracting the rise in rents. However, a renter is not merely paying to occupy a building, but also to occupy a plot, or a portion of a plot, of land where that building is located. And the quantity of land in a given market is fixed. In this way, increased income does tend to be eaten up by land values. David Ricardo described the situation in this way: "***The rent of land is determined by the excess of its product over that which the same application can secure from the least productive land in use.***"

While Ricardo's point was primarily in reference to agriculture, Henry George recognized that since all economic activity requires land, and different geographic areas open the possibility for much greater productivity (due to network effects, strategic location, and other reasons), the law of rent was just as powerful in urban areas.

For example, if a person can make $50,000 more per year with the same skills by moving from Fresno to San Francisco, they will end up paying most of that $50,000 more in rent to San Francisco landlords. Without paying the rent, they cannot access the higher wages available in San Francisco, and since the quantity of land is fixed, once the landlords start setting this price, no more land is going to enter the market to move rents back down. Importantly, this only applies to rent on land – the portion of rent that is paying for the actual building one occupies is not subject to this law, because more buildings can always be built.

Empirical evidence shows that this is largely the case. In San Francisco, the median income is indeed about $50,000 more than the median income in Fresno. Monthly rent for a 2 bedroom apartment in San Francisco is actuality about $2,600 more than Fresno ($3,700 vs $1,100) — roughly $32,000 more a year. The rent paid thus doesn't line up exactly with the increased income (largely because, due to increased densities in San Francisco, a two bedroom apartment occupies less land than one in Fresno) but the rent does rise dramatically more than other costs: groceries are only slightly more...(cont'd on pg. 6)

The Perfect is the Enemy of the Good, Even When it Comes to Raising Public Revenue (cont'd from pg. 5)

From the perspective of the community as a whole, buildings should be exempt from taxation so that owners of locations are encouraged to develop these locations in accordance with their highest and best use. This proposed change in property taxation would yield, to local governments, an increasing amount of public revenue; the rental value of land would increase in response to expanding economic activity, which would increase the population attracted to the area. But, in this case, the increased revenue would stimulate rather than drive away investment in those goods and services which contribute to the overall quality of life.

Business Profits Tax

Over time, the above reforms would make it possible to replace the business profits tax with a low but graduated tax on gross revenue. In addition to greatly reducing the cost of compliance, this tax reform would reward firms that were best at controlling costs (which would, in turn, no longer be expensed to reduce the firm's tax liability). To encourage small businesses (which employ far more people than large corporate entities), some level of gross revenue would be exempt from taxation (e.g., the median gross revenue generated domestically). Above this exempt level, an increasing rate of taxation would be imposed on higher levels of gross revenue.

CONCLUSION

Certainly, there are additional ways by which to reform the means by which all levels of government can raise the revenue they need. But the above describes a good starting point from which to develop public policies that will yield a full employment society and a greater degree of economic equality and equality of opportunity.

The annual tax on buildings is equivalent to the imposition of a sales tax like the tax imposed on other goods annually. A building is a depreciating asset, much the same as an automobile or machinery. A building remains useful only because owners perform regular maintenance and replace roofs, heating and air-conditioning equipment, plumbing and other systems as they wear out or break. Taxing the building adds to the cost of the upkeep necessary to prevent its condition from deteriorating or even becoming unusable over time... (cont'd on pg. 6)

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What Happened to the Freedom Dividend UBI Rent (cont'd from pg. 5)

expensive there than the rest of the country, while rents are triple or more the national average.

A universal income of $12,000 a year, however, would not have the same effect as a rise of wages in a particular place. Why? Because it will not change the difference in productivity between the cheapest land and the most expensive land. In places like Detroit, where land can be had nearly for free, incomes will rise by $12,000. In places where land is incredibly expensive, the exact same rise will take place. For this reason, there will be no increase in demand for land in San Francisco.

Indeed, if land location is a smaller factor in an individual's overall income, the power of landlords to demand higher rents actually falls, so if anything, the highest rents should fall with them. While areas where low incomes currently depress rents may see some uptick, there will be no overall jump in rents across the board. Henry George clarifies Ricardo's position this way: ***"I may have very rich land, but it will yield no rent and have no value so long as there is other land as good to be had without cost."***

In terms of collecting the Freedom Dividend, one plot of land is as good as any other, and so the increase in income can't be easily collected as rent.

However, in the long run, the Freedom Dividend's most ambitious goals will end up supporting landowners more than anyone else if it's not matched with a Land Value Tax. Yang's campaign and supporters likes to point to the impact on economically marginalized communities, particularly in former manufacturing hubs. And they have a point – if the FD is funded by a Value Added Tax, it will move money from areas with more economic activity and thus higher VAT burdens to those with less, and provide an economic base to areas that have lost their manufacturing base due to shifting economic patterns.

If this occurs, there will naturally be more people in those communities looking to buy homes, more businesses setting up or expanding to offering goods and services there, and an expanded tax base that will allow for greater local government investment in services and infrastructure. All of these changes tend to raise land values. While investment in apartments and new homes would offset the potential rise in residential rents to a certain extent, rendering the immediate concerns about rent absorbing overly simplistic, the rise in the values would ultimately mean that those who owned the land in these newly revitalized communities would see the greatest benefits. As their land became more valuable, they would be able to demand higher rent or higher prices for home sales, such that eventually, once the economy had adjusted to this new income source, the returns on land would indeed eat up most of the increased prosperity.

However, if those localities adopted a robust land value tax, the prosperity would end up being more widely shared. Higher land values would lead to greater density, as landowners and developers sought to avoid land taxes while keeping the same revenue. The resulting increase in housing would slow the rise in rents. And as tax receipts grew, governments would have greater capacity to provide services to those in need, to invest in housing directly, or to eliminate regressive taxes. Any of these would allow the increased prosperity from the Freedom Dividend to be more broadly shared... (cont'd on pg. 7)

What Happened to the Freedom Dividend UBI Rent (cont'd from pg. 6)

Ultimately, the accusation that the Freedom Dividend would immediately flow to landlords is overly facile and misunderstands the law of rent. However, if the Freedom Dividend does all it promises, and in fact stimulates the economy, it will run up against George's warning: "***...improvements which advance rent are not only to be included the improvements which directly increase productive power, but also such improvements in government, manners, and morals as indirectly increase it.* Considered as material forces, the effect of all these is to increase productive power, and, like improvements in the productive arts, their benefit is ultimately monopolized by the possessors of the land."**

A UBI like Yang has proposed would only make a substantive, long term difference in the distribution of wealth if it was accompanied by land value taxes, as those taxes are the best tool for governments to divert the benefits that would otherwise flow just to landowners and use them i instead for the enrichment of whole communities.

Cover photo of the State Library of Victoria, in Victoria Australia, submitted by Mark Hassed.

For more of Mark's work, visit: www.abandonedplaces.com.au

"So long as all the increased wealth which modern progress brings goes but to build up great fortunes, to increase luxury and make sharper the contrast between the House of Have and the House of Want, progress is not real and cannot be permanent."

HENRY GEORGE

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