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Government Subsidies

TO SPEED UP LAND PRICE INFLATION

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I HOPE ALL of you read *Fortune's* July story headlined: "Land: The Boom That Really Hurts" and *Time's* October 1 feature on "The New American Land Rush." Both *Fortune* and *Time* laid it on the line that today's crazy inflation in land prices is bad for everybody except the big landowners and land speculators whom it is enabling (in the wonderful words of the economist John Stuart Mill) to "get rich in their sleep at other people's expense" — including most specifically and most expensively at the expense of all the interests represented in this room today, with the Federal government by far the biggest loser.

Said *Fortune:* "Even those who own modest parcels of land (like the plot under their homes) suffer more from the indirect effects of the land boom than they benefit from the inflated value of their property, for directly or indirectly the cost of land enters into the cost of everything they buy.

"It is also an element in the sickness of our cities. Developers bypass expensive, idle land in favor of less dear tracts farther out. Low population densities on the metropolitan peripheries make mass transport uneconomical and foster the one-person, one-car pattern, wasteful of energy and raw materials.

"The cities themselves — pockmarked by parking lots, leprous with dilapidated buildings — lose their urbanity and their social vigor. Though government has poured billions into the cities, the rot does not stop. Nor will it stop as long as land prices continue to run ahead of solid economic reality."

Time is still more explicit that today's land price inflation is bad for almost everybody except, of course, big landowners and land speculators.

Says *Time:*

"For most Americans land price inflation costs more than it is worth. For the homeowner a rise in the price of his home is just a theoretical profit until he sells it" — and, if I may interrupt the *Time* quotation briefly, when he sells it even this theoretical profit is taken away from him by the inflated price of the next home he has to buy, unless, of course, he is leaving his present home to go to heaven. "Meanwhile" says *Time,* "the land price spiral is raising the price of everything the homeowner buys. Packing plants, bakeries, supermarkets, movie theatres, filling stations, widget makers all pass on to their customers the rising prices their owners must pay for the land on which they set up shop. The rising price of farm land is reflected directly in the cost of crops and the cost of food." And once again perhaps I should interject a specific from a farm credit executive quoted in *The New York Times* that at today's prices farmers can't afford to buy land unless they can count on $6 a bushel for soy beans, 55 cents a pound for cotton, and $2.50 a bushel for corn.

And *Time,* like *Fortune,* goes on to say: "Fast rising land prices also aggravate urban decay, suburban sprawl, and even the energy crisis" — because, as I hardly need explain, sprawl makes more and more people spend more and more money to drive more and more miles in more and more cars burning more and more gas to get to and from where they have to go.

This is not the time or place for me to repeat to you what you could already have read in our magazines about the harm today's crazy inflation in land prices is doing to practically everybody except acreage owners and land speculators.

So I have repeated these few quotation sentences to you for just one reason: To the best of my knowledge and belief they mark the first time any major publication has spelled out that even homeowners are in fact big losers by the soaring land prices about which, alas, ninety-nine homeowners out of a hundred have been unthinkingly slap-happy as they watched the market price of the homes they bought for much less climb up and up.

And if ninety-nine homeowners out of a hundred are unthinkingly slap-happy about the inflation in land prices, I can't help wondering if all of you here today realize that this inflation has hit and is hitting the building industry and its customers first and much worse. From 1956 to 1966 land prices inflated 6.19 times as fast as the rest of the wholesale price level, according to the Douglas Commission report, and that report was completed before land prices really took off for the wild blue yonder. From 1969 to 1972 the square foot price of land for FHA houses shot up another 73 per cent!

I wonder how many of you realize how many billion dollars this land price inflation is adding to the cost of local government. I wonder how many of you realize what it did to make the Nixon Administration's 1969-1972 subsidy program, in Mr. Romney's own tragic words, quote "a hundred billion dollar failure." I wonder if you all realize that the crazy inflation in land prices creates the No. 1 threat to the preservation of open space about which the voters are now getting so troubled, for it forces more and more homebuilders to leapfrog farther out into the boondocks to find land on which they can afford to build, thereby forcing the premature subdivision and suburbanization of land which should and could have been left open space until sometime in the next century. And I wonder how many of you realize that the inflation in land prices is by far the biggest single element in the overall inflation George Schultz and John Dunlop are struggling so hard to at least slow down — the overall inflation which is now America's No. 1 economic problem and just about the hottest political issue.

As for the building industry:

The high price of land that has been so profitable for land speculators is bad for land developers, because the more the developer has to pay for raw acreage and the farther out into the boondocks he has to go to find acreage he can afford to buy the less margin he has to cover his land development cost and the less profit he can hope to make on the land acquisition and land development dollars he risks.

The high price of land that has been so good for acreage owners is bad for homebuilders because the more the builder has to pay for his lots the less money he has left to build more sales appeal into his houses, the greater his risk of having to price his product out of the market and the less his chances of selling his houses at a good profit. Thirteen years ago the homebuilders voted 4-to-1 that land was already their number one problem and Nat Rogg said to me "Land is a real killer to the builder. The cost of land has gone up more than all other housing costs combined." The high price of land that has been so good for acreage owners has been equally bad for subcontractors, building material dealers, and building product manufacturers. When a builder has had to pay thousands of dollars too much for his land he has to take that money out of his house somewhere or go broke, so he passes the squeeze on to his subs, he passes the squeeze on to his dealers (or tries to eliminate the dealer and the dealer's mark-up entirely), and he passes the squeeze on to the building product manufacturer, too often by buying the cheapest products he thinks he can get by with.

The high price of land that has been so good for the acreage owner is bad for realtors because realtors live by making sales, and today's crazy land prices are pricing millions of sales of both new homes and used homes clear out of the market. And let's not forget that when a family that could afford to trade up to a better new home elects to stay put instead, the Realtors don't lose just that one sale; they lose up to a dozen sales they could have made as up to a dozen families play musical chairs, each trading up to a better used home, with each of the trade-up sales offering realtors the chance for a trade-up commission.

And finally and most urgently the high price of land that has been so good for acreage owners is bad for the mortgage lenders and mortgage holders, because the more water there is in the land price the less real value the mortgage will represent and the less the mortgage holder's security.

Land prices have now been inflated so high that *Fortune* says that on paper the price of privately owned land now adds up to "a value greater by far than all our boasted investment in industrial equipment." In 1929 all the inflation was in the stock market; land prices had actually been declining since 1926. Today, quite the contrary, by far the worst inflation is in land; stock market prices in constant dollars are well below 1968. Says *Fortune:* "The land sales pitch that the price of land is bound to keep rising cannot be true forever. At some point land prices have got to get back in line with other prices."

The 200-year history of land prices in the U.S. should warn us all that although land prices can climb longer and higher than any other price, when the downturn comes they fall harder and further. Already, *Time* suggests, land prices in many areas have reached the "one-more-idiot-will-pay-them" stage. Already a lot of amateur land speculators, including, alas, some big companies represented here, have had to write off multimillion dollar losses on land ventures they had thought were a sure thing. And now *Fortune* warns us, in what I'm afraid may prove to be a dangerous understatement and underwarning, that quote "A sudden drop in these fattened land prices would have a more traumatic effect on the economy than a stockmarket crash" — repeat *a more traumatic effect on the economy than a stock market crash!*

The land salesman's pitch is that today's land prices are just the result of greater and greater demand pressing on a fixed supply of land. We've all heard that so often that I'm afraid a few people right here in this room may believe it, so I hope they will be grateful if I warn them that this explanation that I hear wherever I go is just plain unvarnished and unmitigated nonsense.

I heard that nonsense before I made my talk at the University of Wisconsin in Milwaukee. Said the Mayor of Milwaukee quote: "We ought to move whole square miles of people out of the city." But the truth revealed by a big study there instigated by the Urban Land Institute is that 40 per cent of all the land in Milwaukee is either vacant land or used only for open-air parking, which is about the same thing.

I was handed that land shortage talk before I made my talk to the St. Louis Chamber of Commerce, and the Chamber's Executive Director wrote me that quote "Our big problem here is that there is no land in the city available for development." So I had to ask my St. Louis audience what they were doing with all the land 335,000 people had vacated to move out of the city since 1950 and what they were doing with all the in-city land more than 200 industrial employers (including some of the biggest like McDonald Douglas and Monsanto) had vacated.

I was handed the same shortage talk before I made my talk to the St. Louis Homebuilders, who told me so little land was available that they could not afford to use it for single family homes four to the acre. But the truth is there is land enough in the area over which the St. Louis homebuilders are already sprawling their homes to house the entire population of the whole state of Missouri at single family density and still have 250,000 acres left over for shopping centers, industrial parks, airports, roads, golf courses, fox hunting, and quite a lot of just plain wilderness.

And in St. Louis famed land researcher Roy Wenzlick debunked the whole land shortage explanation of today's soaring land prices in one short sentence. Said he: "All everyone needs do is look out the airplane window and see for himself that there is no shortage of land ripe for development or redevelopment *in and around any American city.*"

So once again let me assure you it is nonsense to blame a non-existing shortage of land for the way land prices have gone through the roof. On the contrary, I'm pretty sure there are just two big reasons why land prices have been going up so much faster than any other prices, and both those reasons lay the full blame at the door of some level of government.

Quite apart from the all-too-obvious fact that our overall inflation is so largely due to Federal deficit spending, one of these two big reasons why land prices have been outracing all other prices is the reason spelled out by *Fortune* nearly ten years ago — quote "Tax treatment so extremely favorable that it almost exempts land speculation from the ordinary workings of the law of supply and demand." In an economy in which it is hardly too much to say that everything else is overtaxed, idle and underused land needed now for orderly urban growth or redevelopment is so underassessed and undertaxed that its owners can hold it another year at a net tax cost seldom if ever exceeding ½ of 1 per cent waiting for inflation and an often enormous nearby investment of other people's money and other taxpayer's money to multiply its price 10 per cent a year, 20 per cent a year, and sometimes more than 20 per cent of year. If the nominal property tax rate is 5 per cent (which is about average) and if the land is assessed at 20 per cent of market (which is also well above average) and if the owner is in the 50 per cent tax bracket (which is quite likely) his net yearly tax would be 50 per cent of 20 per cent of 5 per cent, and if you get your microscope you can see that his tax cost to hold $100,000 worth of land off the market for another year has been only $500; and during that year he has been able to count on its price going up at least $5,000 and more probably more than $10,000!

This highly inflationary undertaxation of land is mostly the fault of local governments and their almost universal practice of assessing idle and underused land at a much smaller percentage of market than improvements and a much smaller percentage of market than land whose owners are putting it to a use commensurate with its value, but this undertaxation is aggravated and abetted by state laws that mandate farm-value assessment for acreage on the urban fringe as long as its owners at least go through the motions of farming it. Of this perhaps the most notorious example is the so-called farm within a mile of the Chevy Chase shopping center that will continue to enjoy a $25,000 farm assessment until its owner can find someone willing to buy it for $15,000,000, but there are plenty of similar cases around most of our cities. For example, when I was researching for my talk to the Rochester Homebuilders last month I found a 103 acre farm hardly a mile from the Rochester city line whose owner has turned down $1,500,000 for it. That land is assessed at $11,600, so no wonder its owner is in no hurry to sell it until some buyer is willing to pay him more than 150 times its assessed value!

The inflationary impact as this undertaxation is capitalized into higher and higher land prices is at once so enormous and so obvious that I don't think I should waste any more of your time spelling it out.

Now let's consider the second and still more costly government contribution to accelerated land-price inflation — the way all levels of government are speeding up land price inflation by pouring billions of subsidy dollars into the land market.

Perhaps the biggest and certainly the least recognized and least understood of these subsidies to land-price inflation is the way almost all local governments let landowners in and around our cities get away with paying only a microscopic share of the enormous capital costs of providing the public facilities needed to make their land reachable, livable, and richly saleable — capital costs for more roads, more water lines, more water supplies, more sewer lines, more sewage disposal facilities, more police facilities, more fire fighting facilities, more schools, more colleges, more libraries, etc., etc., etc. Around New York the Regional Plan Association says this public investment on which the land seller now gets an almost free ride costs other taxpayers an average of $16,750 of 1967 purchasing power for each added home — or say $20,000 of today's shrunken value. Across the country the Southern California Real Estate Council added up these same capital costs last year to $18,500, around Los Angeles, so we can safely estimate that their national average must be more than $15,000 for the land needed for one more home. So even when the developer pays all the on-site costs, the other capital costs to which the landowner now makes almost no contribution must average well over $10,000 for each added home. If we assume four homes per acre (which is safely below today's average) that would multiply out to $40,000 an acre!

And a public subsidy of $40,000 an acre is one whale of a subsidy to make other taxpayers — mostly local taxpayers — pony up to enable the landowner to sell his land for say $10,000 an acre! Without that enormous subsidy much of the land whose price is now inflating so fast might well be worth nothing at all.

Most obvious but still too little understood is the way direct payment subsidies from both the Federal and state governments get capitalized into higher and higher land prices. For example, the New York City Housing Commissioner told me that when the state launched its Mitchell-Lama subsidy program for middle income housing the price of land suitable for Mitchell-Lama projects doubled overnight. And lest anyone imagine that such capitalization of subsidies into inflated land prices is confined to New York, perhaps I can help you realize that subsidies have this same inflationary impact on land prices everywhere by reminding you that in San Francisco the success of the subsidized Golden Gateway renewal project was promptly capitalized into a 400 per cent increase in the price of the surrounding land and the success of the subsidized western addition No. 1 was capitalized into such an increase in surrounding land prices that three times as big a subsidy was needed to enlarge the project with western addition No. 2!

The multibillion dollar Federal subsidy program from 1969 to 1972 that Secretary Romney so sadly called quote "a $100,000,000 failure" and the Chairman of the Joint Economic Committee scorned as quote "a failure that has left the Federal government in hock for $100,000,000" was intended to help "make a good home available to every family at a price that family can afford to pay," but its price consequence was exactly the opposite: Those subsidies did indeed induce a much-needed and long-overdue increase in new home construction — an increase that under other circumstances might actually have helped bring housing prices down by easing the shortage of good houses, but alas! so much of those subsidies was diverted into such an increase in housing costs and most disastrously to such an acceleration in land-price inflation that today many middle income and even upper middle income families are being priced out of the unsubsidized housing market, so (to cite one extreme example) New York State and New York City are now getting together to provide a $250 a month subsidy to hold the rent for a six-room apartment in a jointly subsidized renewal project down from $675 a month to $425!

And this at long last brings us to the conclusion reached by Dr. Mason Gaffney, whom many now consider America's No. 1 land economist, that quote:

"The biggest reason big Federal and/or state subsidies seem to be needed for housing and urban renewal is to provide a partial repeat — partial — offset to the enormous subsidy governments give land price inflation by undertaxation and a partial offset to the enormous penalty so many local governments impose on new improvements — including new housing — by taxing them more heavily than any other major product of American industry except hard liquor, cigarettes, and perhaps gasoline.

Said the Douglas Commission sadly: "It seems unbelievable that we should impose such an enormous tax penalty on something we need so badly, *but we have.*"

So now let me close with a parting work of sympathy for Secretary Schultz, Secretary Lynn, and Cost of Living Councilor Dunlop, who have come here to face the unhappy task of defending the Administration's decision to abandon its ultra-costly attempt to meet our urban needs and our housing needs by pouring in more and more Federal subsidy dollars. I don't envy them their task, but perhaps it will cheer them to know there is one person at this conference who thinks their decision was inevitable.

I might add that I also think Secretary Lynn's decision to hand out his reduced subsidies directly to poor people is probably good politics, even though I'm pretty sure that no matter how the subsidies are handed out most of them will end up being capitalized into land prices. Anyhow, the smaller the subsidy the less the subsidy will contribute to accelerating the pace of land-price inflation.

Says *Fortune:* "The most important step government should take to improve housing conditions is to stop pursuing policies that inflate the cost of both land and construction."

To this I for one say a loud Amen.

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