

November 7, 1990

Mr. Mikhail Gorbachev, President
Union of Soviet Socialist Republics

Dear Mr. Gorbachev:

The movement of the Soviet Union to a market economy will greatly enhance the prosperity of your citizens. Your economists have learned much from the experience of nations with economies based in varying degrees on free markets. Your plans for freely convertible currency, free trade, and enterprises undertaken and managed by individuals who receive the profit or bear the losses that result from their decisions are all highly commendable. But there is a danger that you will adopt features of our economies that keep us from being as prosperous as we might be. In particular, there is a danger that you may follow us in allowing most of the rent of land to be collected privately.

It is important that the rent of land be retained as a source of government revenue. While the governments of developed nations with market economies collect some of the rent of land in taxes, they do not collect nearly as much as they could, and they therefore make unnecessarily great use of taxes that impede their economies---taxes on such things as incomes, sales and the value of capital.

Social collection of the rent of land and natural resources serves three purposes. First, it guarantees that no one dispossesses fellow citizens by obtaining a disproportionate share of what nature provides for humanity. Second, it provides revenue with which governments can pay for socially valuable activities without discouraging capital formation or work effort, or interfering in other ways with the efficient allocation of resources. Third, the resulting revenue permits utility and other services that have marked economies of scale or density to be priced at levels conducive to their efficient use.

The rental value of land arises from three sources. The first is the inherent natural productivity of land, combined with the fact that land is limited. The second source of land value is the growth of communities; the third is the provision of public services. All citizens have equal claims on the component of land value that arises from nature. The component of land value that arises from community growth and provision of services is the most sensible source of revenue for financing public services that raise the rental value of surrounding land. These services include roads, urban transit networks, parks, and public utility networks for such services as electricity, telephones, water and sewers. A public revenue system should strive to collect as much of the rent of land as possible, allocating the part of rent derived from nature to all citizens equally, and the part derived from public services to the governmental units that provide those services. When governments collect the increase in land value that results from the provision of services, they are able to offer services at prices that represent the marginal social cost of these services, promoting efficient use of the services and enhancing the rental value of the land where the services are available. Government agencies that

use land should be charged the same rentals as others for the land they use, or services will not be adequately financed and agencies will not have adequate incentive or guidance for economizing on their use of land.

Some economists might be tempted to suggest that the rent can be collected publicly simply by selling land outright at auction. There are a number of reasons why this is not a good idea. First, there is so much land to be turned over to private management that any effort to dispose of all of it in a short period would result in an extreme depression in prices offered. Second, some persons who could make excellent use of land would be unable to raise money for the purchase price. Collecting rent annually provides access to land for persons with limited access to credit. Third, subsequent resale of land would enable speculators to make large profits unrelated to any productive services they offer, resulting in needless inequity and dissatisfaction. Fourth, concern about future political conditions would tend to depress offers. Collecting rent annually permits the citizens of future years to capture the benefits of good future public policies. Fifth, because investors tend to be averse to risk, general uncertainty about the future will tend to depress offers. This risk aversion is sidestepped by allowing future rental payments to be determined by future conditions. Finally, the future rent of land can more justly be claimed by future generations than by today's citizens. Requiring annual payments from the users of land allows each year's population to claim that year's rent. While the proceeds of sales could be invested for the benefit of future generations, not collecting the money in advance guarantees the heritage of the future against political excesses.

The attached Appendix provides a brief technical discussion of issues of the duration of rights to use land, the transfer of land, the assessment of land, social protection against the abuse and subsequent abandonment of run-down property, and redistribution among localities to adjust for differences in natural per capita endowments. While these issues need to be addressed, none of them present insoluble problems.

A balance should be kept between allowing the managers of property to retain value derived from their own efforts to maintain and improve property, and securing for public use the naturally inherent and socially created value of land. Users of land should not be allowed to acquire rights of indefinite duration for single payments. For efficiency, for adequate revenue and for justice, every user of land should be required to make an annual payment to the local government, equal to the current rental value of the land that he or she prevents others from using.

Sincerely,

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The names of individuals appear in the order in which they agreed to sign the letter. No individual speaks for any organization with which he or she is affiliated.

Appendix on Technical Issues

All individuals and enterprises should have the right to continue using the land they have been using, for as long as they are prepared to pay the rent of that land. The amount of rent to be paid will vary as the economy evolves. As is traditional in countries with market economies, if land is needed for some public purpose such as a highway, the judicial process should guarantee the user fair compensation for any improvements that have been made in good faith. Every user of land should also have the right to transfer ownership of the improvements on the land, together with the right to continue using the land upon payment of rent, to any buyer on any terms upon which they mutually agree.

For the rent of land to be collected publicly, land must be assessed, and then reassessed regularly. The assessment process is simplified by the fact that land rental values tend to change smoothly with location. Initially, a map of the value of land can be made by auctioning scattered sites on a rental basis, and then interpolating for the value of other sites, based on the experience of Western appraisers and assessors regarding the manner in which the value of land varies systematically. To update assessments in future years, the assessment office would auction sites that had been relinquished by their users, or sites with improvements that were almost fully depreciated, that had been acquired in voluntary transactions. Interpolation would again be used to estimate the rent of sites that had not been transferred.

With all or nearly all of the rent of land collected publicly, it would be necessary to guard against the possibility that users of land with fully depreciated improvements would abandon their property, leaving the State to demolish the improvements in preparation for the next use of the site. This potential problem can be avoided by requiring every user of land to post a government bond as a "security deposit" that the land will not be abandoned in a run-down condition. Interest on the bond could be applied to the annual rent.

Collection of the rent of land is best managed by local governments, but justice, as well as efficiency in migration incentives, requires that the part of rent that is attributable to nature rather than community development be shared on an equal per capita basis. Thus there is need of clearinghouse mechanism, into which all localities would deposit collections of rent from nature in excess of the average per capita amount, and from which other localities would receive compensation for their deficiencies of rent from nature, relative to the average per capita amount.