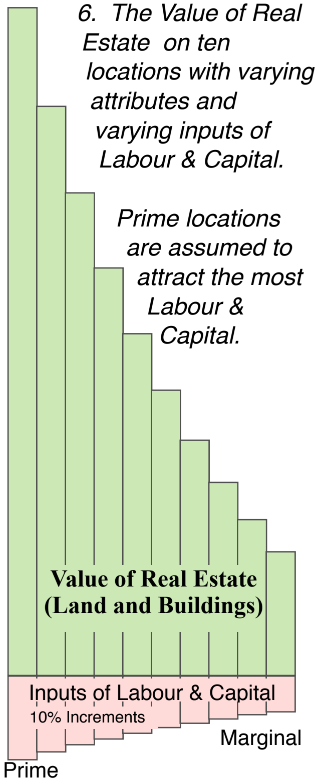


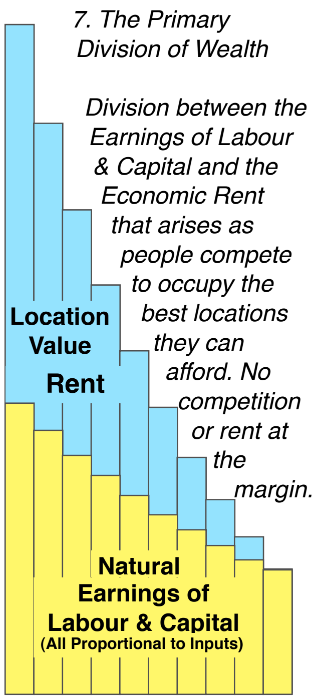
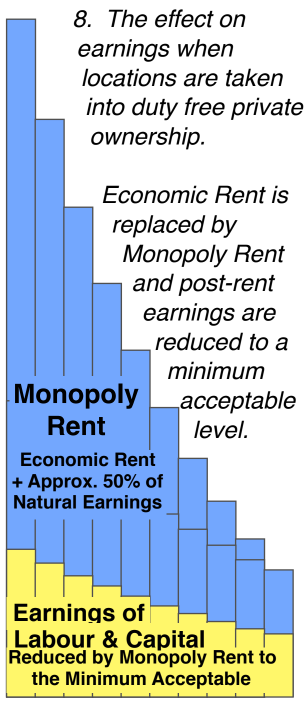


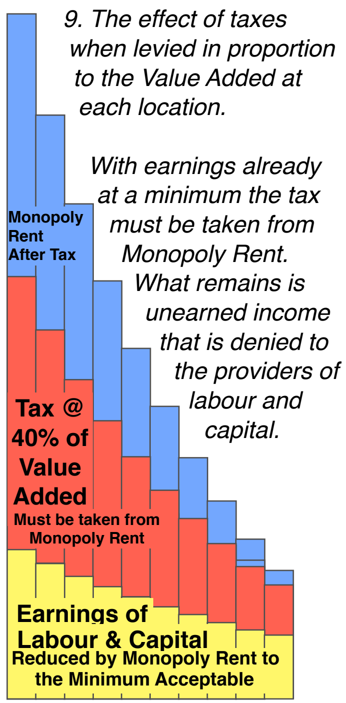
Diagram 6 is similar to Diagram 3 except that the inputs of labour and capital on each location are not (unrealistically) assumed to be equal but to vary. The prime locations are more realistically assumed to attract more or better inputs than at the margin.

Ethical Considerations

The principle 'thou shalt not steal' is a feature of every civilisation and is a cornerstone of economic behaviour. The natural basis of property is that it belongs to the producer. The producer only loses what they produce if they give it away voluntarily or someone steals it from them. When governments levy a tax on the earnings of labour and capital they steal what the provider of that labour or capital produces - it is simple theft - made respectable only because it has become normal. Location value is not produced by any individual but by the whole community. It is therefore a natural source of public revenue that does not involve any theft.

Failing to collect location value for the community allows it to become the property of those who do not create it. It leads to speculation in land, leading to booms and busts and land being underused and held





Diagrams 7- 9 show how the distribution of wealth produced within a community (as shown in 6) varies according to systems of land tenure and public revenue. The Primary Division between Rent and Earnings is shown on 7 & 8. Diagram 9 shows the distribution between 'earned' and 'unearned' income that arises when taxes are levied at all locations in proportion to the Value Added at each location. The earned income, unearned income, and public revenue at (9) should be compared with that at (7) if all the Economic Rent were collected as public revenue.

out of use. Idle and underused land represents a sad failure of the Real Estate Market as it currently operates.

Likewise where banks create money as debt for inflated mortgages against capitalised land rental values credit for genuine value creating projects along with the whole monetary system is compromised.

The Henry George Foundation of Great Britain
PO Box 6408, London. W1A 3GY Tel: 0800 048 8537
www.henrygeorgefoundation.org henrygeorgefoundation@gmail.com
The Henry George Foundation of Great Britain is a company limited by guarantee
registered in England no. 00956714 and a charity registered in England under the Charities Act 1960, no. 259194
Meetings and classes are held at 11 Mandeville Place, London, W1U 3AJ.
(Courtesy The School of Economic Science).

HENRY GEORGE FOUNDATION

HOW TAXES ON REAL ESTATE AFFECT THE MARKET ECONOMY

By
David Triggs

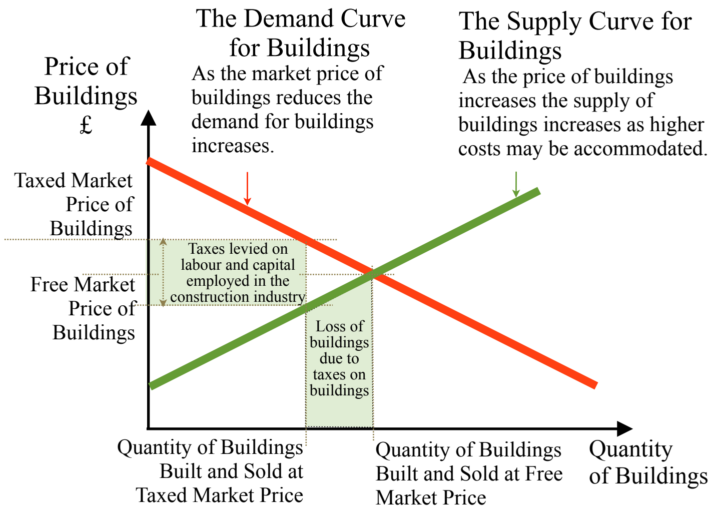
The function of the Real Estate Market is to facilitate trade in land and buildings. Unfortunately the tax systems that governments currently employ inhibit this, other trades, and the wider economy. This paper describes how such damage arises and how it could be avoided. It considers both aspects of the the Real Estate Market and applies conventional supply and demand theory to show the impact of taxes on the trade in buildings and land respectively. It moves on to show how the Real Estate Market could be improved by simply collecting a value that the community as a whole creates in lieu of taxes that take from individuals and corporations value which they create when they employ their own capital and labour.

The Real Estate Market for Buildings

Taxes on Labour and Capital

Figure 1. below shows how taxes on the labour and capital employed in the construction industry has three effects:

1. The price that must be paid by purchasers of buildings is increased.
2. The incentive/reward/return to builders is reduced.
3. The viable quantity of buildings brought to the real estate market is reduced.



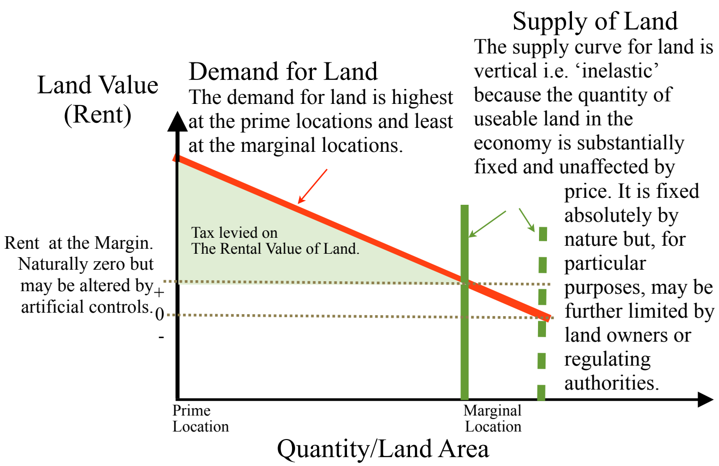
The Effect of Taxation on the Market Price and the Quantity of Buildings Built in the Economy

Figure 1.

The Real Estate Market for Land

Taxes on Land Value (Rent)
Figure 2 below illustrates how taxes on the rental value of land may be collected as public revenue without:

1. Reducing the amount of land available for production or for residential use or:
2. Increasing the Rent which a potential tenant would need to pay. This is because the Rent is determined by competition between potential tenants not by who collects the rent. What a prospective or existing tenant can afford and is willing to pay to a private owner is not changed if that private owner is obliged to pay a like amount to a public authority.



The Effect of Collecting The Economic Rent of Land on the Market Price and Quantity of Land Available in the Economy

Figure 2.

Entrepreneurship and Barriers to Entry

The scope for entrepreneurship and enterprise in the Real Estate Market is maximised where the barriers to entry at the margins of viable economic activity are at a minimum. At the margins land is normally abundant and rent is at a minimum. In a primitive society rent at the margin is naturally zero creating a zero barrier to entry. In a more developed society artificial scarcity is created by both privatisation and public control.

The effect of privatisation is to add a monopoly rent to the natural rent at the margin and everywhere else. It also leads to the capitalisation of the rental value of land and in turn to land speculation where land is held out of use or underused as the owner waits upon an increase in capital value. Such speculation inhibits the construction of good housing and commercial buildings and the most efficient and socially beneficial use of real estate.

The nature and extent of public control over the use of land will, in a democracy, reflect the social values of the society. Societies will, for example reserve and limit the locations that may be used for parks, civic buildings, and places for worship, or brothels, nightclubs and casinos. etc. They could also decide to reserve certain land for marginal industries, trades and shops or for housing for the poorest in their society. All such measures will affect the rental value of land and if this were being collected as public revenue the public authorities would be able to take such revenue implications into account in

making their land use decisions. Likewise land owners whose land gains or loses value as a result of a land use decision in relation to their own or a neighbours land will charged or compensated accordingly as their land value charge will be adjusted to suit.

The Economic Differences Between Land and Buildings

The key economic difference between land and buildings arises from the simple fact that buildings are man made whilst land is freely provided by nature. A further difference is that every plot of land has a unique location whilst a similar building may be constructed at numerous locations.

The economic significance of these differences is that locations in a developed economy vary on account of the presence, protections, and services provided by the whole community rather than the work of any individual or firm. The construction and maintenance of every building depends upon the employment of labour and capital. In economic terms every building bears a 'cost of production' and, in a fully competitive market its economic value will be no more than the costs associated with producing its like again. A building's economic value thus arises from 'production' and is due to the work of people.

In contrast land has no cost of production, as Mark Twain famously said, "they aren't making it any more". Its economic value is due to the fact that every form of economic activity depends upon the actors (the providers of labour and capital) having access to it. The economic value of land may thus be considered to arise from 'obligation' rather than 'production'.

The Primary Division of Wealth
The Rent of Land and The Earnings of Labour & Capital

This difference in the source of value between the 'rent' of land on the one hand and the 'earnings' of labour and capital on the other accounts for the 'primary division of wealth' between 'rent' and 'earnings' that arises in every economy. In a simple economy with little specialisation or trade, the average and total wealth produced is small but almost all is retained as earnings for the suppliers of labour and capital. In contrast where the economy is well developed and there is much specialisation and trade, wealth production is much more efficient. The per capita and total wealth produced increases. Competition for the best locations obliges the suppliers of labour and capital (including builders) to pay more of the wealth they produce in rent leaving them with proportionally (but not necessarily absolutely) less earnings.

The Effects of Monopoly
Builders compete in the real estate market for exclusive possession of the best location they can afford from the earnings of their labour and capital. The amount that a builder needs to pay to secure a site at a particular location is thus determined only by what they and their competitors can afford, and the amount of suitable land available in the Real Estate Market. Prospective builders at supra-marginal sites evaluate the advantages of building on such a site against the extra payment they will be obliged to bid to get it. The net earnings of their labour and capital is thus reduced by the amount they must pay for the use of land. The base or datum for their evaluations is the cheapest land that is available to them. Since land has no cost of production one might expect land at the margin i.e. land that is barely worth building upon to be freely available without charge - as of course it was in earlier times. Today however, with full land enclosure and economic development, land has become effectively monopolised by a sector of the community such that nowhere is land freely available without charge.

The effect of this is that the basic or marginal building firm's earnings do not reflect the full value of what they produce but rather the least they can survive on and the net earnings of even supra-marginal building firms are the least they are prepared to accept. The building industry, along with other basic industries that depend upon the earnings of labour and capital has become marginalised

so that with an economic downturn mere inconvenience quickly becomes a crisis!

The Significance of Location and Taxes

Figures 3. and 4. below illustrate, in different ways, how the employment of construction labour and capital will produce a value of real estate that varies depending upon where they are employed i.e. the land location. In each diagram the height of each column represents the value of the real estate on each of ten construction sites that vary only in their location. Below each value of real estate column is a column that represents the input of labour and capital that has been used to produce the real estate value. In Figure 3. the input of labour and capital is assumed to be equal on each site and the value of the building varies - a maximum on the prime location and a minimum on the marginal location. Figure 4. shows the different inputs of labour and capital required on the same ten sites to produce real estate of the same value. The 'Supply Curve', referred to earlier, has been superimposed on this diagram to show how it reflects the input needs of successive locations.

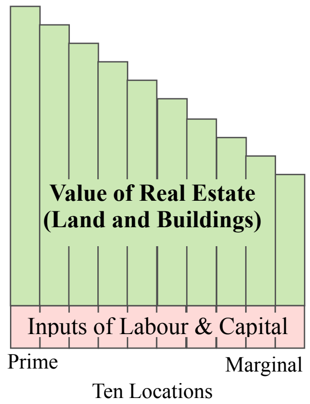


Figure 3.

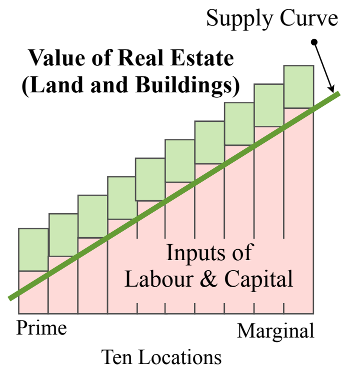


Figure 4.

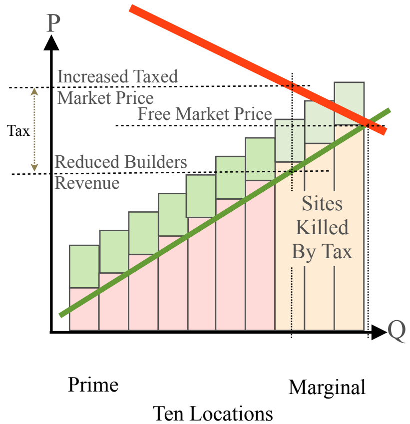


Figure 5.

Figure 5. Combines Figs. 1 and 4 to show how marginal and even supra-marginal sites may be made unproductive by taxes if they are levied on the labour and capital employed.

This illustrates how transaction taxes levied on Real Estate Value i.e. on the earnings of labour & capital, damage the Real Estate Market and the general economy. Diagrams on the next page show how this could be avoided if the Location Value - Rent (as shown in Fig.7.) were to be collected instead.