Henry George School Offers Solutions to Deepening Urban Decay

By David Domke

The *New York Times* recently reported the results of a five-year study by the Regional Plan Association which predicts a dire future for the New York metropolitan region. Looking ahead to the year 2020, the report predicts "a bleak landscape of crumbling urban cores, increasingly isolated wealthy enclaves, transportation paralysis, deteriorating air and water quality and feeble economic growth," unless the region immediately begins a massive project to improve transportation, provide better education and starts to rejuvenate urban areas. The *Times* quotes H. Claude Shostal, the association's President: "It may be the last opportunity we have."

The report offers an alternative vision, based upon the possibility that the region's citizens and politicians will "summon the will and resources to begin a multi-billion dollar campaign" to effect changes that the report says are critical to the region's socio-economic future. In this scenario, "residents zip about in high-speed trains on a fully interconnected regional rail system... the aging urban centers have been recaptured as places to live, work and play and lifelong education and job banks connect the population to new opportunities in the global economy."

Dr. Kris Feder

In previous reports the Regional Plan Association, the oldest urban planning group in the U.S. and whose board of directors "move in the upper circles of the region's business and politics," according to the *Times*, had recommended measures to manage the regions "uncontrolled" growth. Now, according to Gary C. Wendt, the association's chairman, "the issue is no longer how to manage growth, but how to find growth to manage." New York, he said, is no longer a "tireless colossus, building and rebuilding itself through some untended growth machine. Our success is no longer guaranteed."

The cost of this revitalization? According to the association – $75 billion over the next 25 years; $25 billion of that just for the 25 new miles of track needed to interconnect the various existing train systems throughout the region. Significantly, the *New York Times* article said that while all three governors of the tri-state region and Mayor Giuliani said "generally supportive things" about the report's recommendations, "none embraced any new system of taxation to raise money" to implement the needed changes.

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Such a massive influx of revenue would have to come from somewhere, of course. But with major cities still reeling from the recession, and suffering both a diminishing tax base and the partial withdrawal of federal funds, how might this come about? In the political arena, the only seemingly new perspective on taxation is a "flat" one; perhaps a fresh, three-dimensional view is needed.

On Saturday, January 27th, the HGS offered a seminar offering just such a fresh perspective. Kris Feder, Professor of Economics at Bard College, and Steve Cord, President of the Center for the Study of Economics in Columbia, *(continued on page four)*

Taking on the Urban Land Question – in Theory and Practice

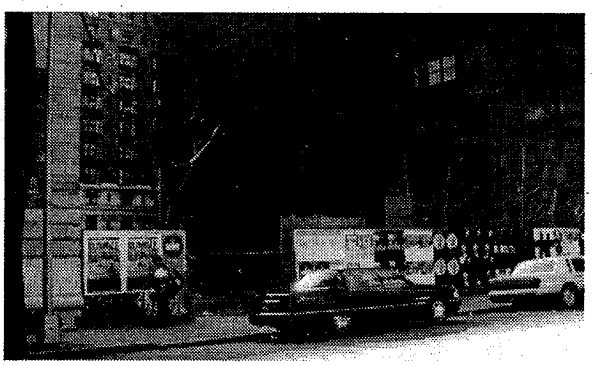
(continued from front page) Maryland, elucidated theoretical and practical approaches to sensible public revenue strategies.

Dr. Feder began by saying that land is a huge part of the country's economy – about two-thirds of this nation's 20 trillion dollars worth of assets, and "the rent of land, excluding buildings and other improvements, is about 60% of that figure." This figure does not include the economic value of natural resources and government owned land.

"Rent largely escapes federal taxation," Dr. Feder stated. "First of all, real estate enjoys very special tax breaks that other parts of the economy do not. One type of special write-off is the depreciation allowance." This write-off has always been an especially generous one – much above the wear-out that buildings actually undergo. And any new owner "gets to depreciate the building all over again.... Land as a component of real estate is chronically underestimated and pays virtually no federal income tax what-so-ever."

The upshot is, real estate, and land in particular, do not pay much in the way of taxes.

The depreciation allowance, Dr. Feder pointed out, "is the mechanism by which income is converted into capital gains." If, in other words, the amount of depreciation write-off exceeds the actual depreciation of the building's market value, that extra value goes to the landlord as a capital gain when the real estate is sold. So, don't capital gains taxes capture part of the economic rent of land? Yes, some, Dr. Feder said – but "they are low and there is always talk of making them lower." Plus, "there are all kinds of exemptions and exclusions that mean capital gains escape taxation, virtually altogether. If you average in both depreciation and special exemptions, you get a figure that is, on average, about 7%. For example, homeowners who sell their house and buy a new one within a year, can exclude up to $150,000 in capital gains.



This lot, spanning through the block from 28th to 29th Streets, between Fifth and Madison Avenues in Manhattan, is actually two lots – vacant since 1986 when the convent and chapel they once contained were razed. One fourth of the property is owned by St. Leo's R.C. Church and is tax-exempt. The rest is still owned by St. Mary's Convent, but a developer, Richard Calico, owns an option on the property. Market value of the entire two-parcel lot, according to the NYC Assessor, is $6,205,000. Annual tax liability of the non-exempt portion is $208,768 – for an effective tax rate of 3.36%. (For it is unlikely, after all, that the exempt portion of this parcel will be sold separately.) Although the neighborhood is not economically robust – a S.R.O. hotel is nearby – the lot is very convenient to bus and subway transportation, and many midtown attractions. Across 29th street sits the landmark Church of the Transfiguration, the famed "little church around the corner."

If you are over 55, you have a blanket exclusion from capital gains on your home. Major commercial investors [such as insurance companies and pension funds] – who own the largest chunks of real estate – are excluded from capital gains tax. Foreign investors also enjoy a similar tax exclusion. The upshot is, real estate, and land in particular, do not pay much in the way of taxes."

Dr. Feder then got to her main point. "I believe that rent of land is the most equitable tax base we could envision. First of all, land value is not given by the landowner. The natural resources themselves are a "gift" and the social value of land is mostly created by government, which builds roads, schools, transportation – all those things that make people want to come and live in a particular area in the first place. If we were to find a way to publicly collect that rent through our democratic system and distribute it in a reasonably fair way, it would be a way to distribute the natural opportunities among individuals, among generations – even among nations, in a more peaceful world."

Prof. Steve Cord

Further, land value taxation confers efficiency benefits, said Dr. Feder. "Unlike all the other taxes we have, a tax on rent does not penalize production. We tax sales, we tax income, we tax wages – all these taxes are essentially penalties for being a productive person. But a tax on rent, or on the value of land, has as its base simply the opportunity cost of holding on to a piece of land, regardless of how its used. The tax is not contingent upon productivity, and is therefore not a deterrent to being productive." Contingent to this fact, Dr. Feder observed that a significant amount of land value tax would channel private savings into capital formation. "Why? Because when you invest you want to find something that will hold its value, in this case either land or fixed capital. And if land rent is publicly collected, more savings will go toward capital formation – ultimately lowering the price of acquiring capital." Thirdly, a tax on land rent would lower land prices, easing credit restrictions and making land more accessible. "Ultimately, this would allow common people to compete with the rich and large corporations on more even footing for the productive use of land."

Of course, a higher land tax would reduce the incentive for speculating in land. "Land speculation is obstructionist; it produces a sort of leap-frog, "scatter-shot" development as developers seek out land not held by speculators. Many commuters may pass miles and miles of derelict, unused land on their way to and from work." Using a land tax to spur urban renewal is the easiest and most efficient way of solving many of our cities' chronic problems, according to Dr. Feder.

In conclusion, Dr. Feder proposed a few policy ideas. One, "capital gains tax cuts do not reward investment, they reward land speculation and real estate hoarding. We should cut true capital gains taxes and not land gain taxes. Secondly, we shouldn't allow buildings to be depreciated over and over again. The real estate industry is the most powerful lobby in the country" and it is their power which is the strongest inhibiting factor to land policy reform. "Thirdly, we should do away with the tax deductibility of mortgage interest; such interest is the main reason why our society is building a huge pyramid of debt." Dr. Feder summed up by saying that "these changes alone could eliminate the federal deficit, turning deficit into surplus. To begin to do that, we need a land value study, at the federal level, that would asses land value for the entire country. At the

moment, we have no reliable statistics to point to the amount of value that's really out there."

Prof. Steve Cord was next up to speak, to address his specialty: the issue of two-rate property taxation. Dr. Cord, drawing on years of experience dealing with local governments, gave a practical and down-to-earth guide on how to approach municipal taxing authorities. Every time he is in Washington, DC, he said, and begins to talk about the land tax, "they don't want to hear it. They tell me that real estate taxation is strictly a local issue. Well, it isn't. For a good part of this country's early history, the federal government taxed land directly, as Henry George pointed out." However, he went on to say, at least they will listen at the local level.

Dr. Cord reported that there are 16 cities in America and 700 cities world wide that tax land at a higher rate than improvements. The two-rate system, Dr. Cord believes, is the only way presently to move toward the single tax. People first need to be educated to the value of a land tax; the only practical way to do so is gradually, by showing the benefits of an incremental change from a tax on improvements to a tax on land. Philosophical approaches are not efficacious, he said. "They don't want to hear it; they don't have time. They only want empirical results. And don't present it as a change in assessment; present it as a change in tax rates. The last thing they want is a challenge to their methods."

Dr. Cord said it would be "desperation" and not philosophy that will eventually make politicians wake up to the necessity of a land tax. "I cannot see New York or any city prospering in the long run with the present tax system," said Dr. Cord.

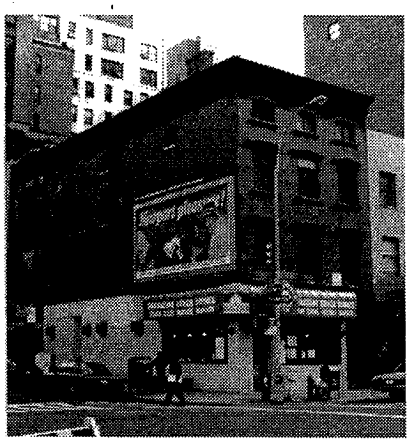
This winter the Henry George School is offering a new course that tries to find the root causes for many of these problems – as well as offer some solutions. Team-taught by George Collins and Lindy Davies, *Taxes, Real Estate and Urban Decay,* offers a hands-on, workshop experience and includes projects designed to demonstrate the debilitating effects of land speculation in New York City – and the rejuvenating potential of a shift to LVT.

According to Mr. Davies the new class "will give our alumni a way to apply Georgist theory to today's economy using material culled from real-world property assessment." Students will be able to test the insights of Henry George regarding the real role of land in the economy, using such practical tools as Prof. Cord's formulas on how to shift to a two-rate (or land only) property tax.

It has always been the intention of this school to give our students something more than just philosophy.

"We do not have the resources available to do a broad study," continued Mr. Davies, "so we have come up with a way to probe the problem in depth. Our students are going into their own neighborhoods and analyzing specific properties, using the techniques of real estate assessment, informed with Henry George's ideas. Our goal is to create a portfolio of researched sites – which we can publish and use in other classes – and will include a study of how the various areas would be affected by a shift to Land Value Taxation." Mr. Collins added: "It has always been the intention of this school to give our students something more than just philosophy. This class offers a hands-on methodology that shows our students a real-world application of land value taxation. We hope to give our students something that is both contemporary and compelling."

The class, composed of twelve members who have completed at least two of the school's courses in *Principles of Political Economy,* is hard at work. One field trip to the Manhattan Assessor's office has taken place, and others are planned. Students have researched, measured, photographed, and (in some cases) interviewed neighbors of some four dozen New York sites thus far.



Here is a classic piece of underused real estate, right in the middle of an up-and-coming neighborhood. Except for the diner on the ground floor, this building on the southeast corner of 28th St. and Lexington Avenue is completely unused. Located close to transportation, shopping at 34th St., and "Hospital Row" nearby to the east, this neighborhood has had much high-rise construction in recent years. It also has its share of vacant lots and "taxpayers." This property enjoys New York City's "8-30% Limitation," ensuring that taxes will rise very gently, even in a galloping market. Assessed market value of land & building is $560,000, of which $213,000 is (nominally) land value. Tax bill for '96 is $23,709 – a seemingly hefty sum for one luncheonette to raise.

Meanwhile, on the heels of the Regional Plan Association's report, the *Times* on February 19 bannered a front page story headlined "Region's Economy in Fundamental Shift; Lag in Recovery Prompts Fears of Decline." The article painted a bleak picture of the area's current economic stagnation: "Through the darkest days of the recession in the late 1980s and early 1990s, there was a certain tenet of faith in the New York region: Like the seasons, the business cycle was eternal, and when the downturn was over old-fashioned growth would return." But while that faith may have proven true for much of the country, the New York area "has recovered only about a third of the 770,000 jobs it lost, and shows no sign of quickly regaining the rest."

While the economy is no longer sinking, "the recovery has become a puzzling economic phenomenon in its own right.... Economic growth since 1992 has been weaker, spottier and downright stranger than anything before it, because so many of the region's industries have been fundamentally rearranged and in some cases seriously eroded." Attempting to account for these profound shifts, the *Times* pointed to "pressures compounded by fierce competition from other parts of the country and the world where labor costs are lower and where governments spend lavishly to attract new business."

Layoffs are happening in record numbers and "have swept the once inviolate public sector as cities and states confront swelling deficits. In addition, Republicans are now in power in New York City and the three surrounding states, and all are on a crusade to cut government spending in the hope that lower taxes will spur business expansion and lure new companies. But so far that has not happened." The picture gets bleaker still. Referring back to the Regional Plan Association's study: "Perhaps even more unsettling, the study found that the New York region's biggest industries – financial services, the electronic media and publishing, the arts and tourism, health services and fashion – suffered steep losses in their share of the national and global markets. On average, it said, the industries' market share shrank 25 per cent by 1992 from 1982...'We might limp along for another decade,' said Claude Shostal, president of the Regional Plan Association, 'but if nothing changes we could be facing an economic abyss.'" – *D.D.*