How the U.S. Government Collapsed the Economy, and How to Build It Back Much Better

The U.S. Government caused the 2020 economic collapse, the U.S. Government should build it back better.

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#affordablehousing #banks #landownership #mortgages #propertytax #recessions land tax

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The 2020 economic collapse was not due only to the Covid-19 disease, but more to the policy response to the virus. The optimal policy would have been to compensate all persons who suffered a loss. Then the economic losses from Covid-19 would have been shared equitably.

Consider, for example, a restaurant that was forced to shut down. Having suffered a loss of revenue, the owner would have applied to the IRS for relief. The owner would have been paid, say, 90 percent of the lost revenue, provided that the owner kept paying the employees as well as the utilities and rental or mortgage payments. There would be huge penalties for fraud. Note that the application would be to the Internal Revenue Service, not to some bank. Under the programs of 2020, the banks served the big players and left out small enterprises, especially sole proprietors, that were unable to get funded.

Other elements of optimal pandemic policy would be to provide plenty of test kits, so that anyone would be able to find out if one were infected. Also, government chiefs should have been promoting rather than ridiculing preventive measures such as effective masking and physical distancing.

Shutting down enterprises such as hotels and restaurants would have depressed the economy, but not nearly so much as occurred. Compensation to those with lost revenue would have preserved the economic infrastructure, the general and company-specific skills of workers, the supply chains, and the financial operations such as rentals and mortgages. It has been noted that recent economic performance has been K-shaped, with some enterprises and workers prospering and others facing devastation. Compensation would spread the cost to the whole economy rather than concentrate it along the lower portion of the K.

The 2020 recession was quite different from the usual business cycle. What usually happens is that as the economy recovers from a recession, such as after 2009, vacancies are reduced and then, because the supply of land is fixed, rents start to rise. As real estate prices rise, helped by cheap credit and government spending, speculators jump in and help raise property values to a height making dwellings unaffordable. Meanwhile, interest rates rise back up, further increasing the monthly cost of real estate. As we observed in 2008, construction stops, property values then fall, mortgages default, and the financial system follows real estate to the abyss.

But in the beginning of 2020, interest rates were still low, and the economy was booming. The U.S. crash of 2020 was due mostly to the failure to respond to Covid-19 with testing, compensation, and sane protective measures.

The Biden administration now has the excellent slogan, “build back better.” How can we rebuild the economy better? We can do it by removing the governmental obstacles that prevent a rapid and ful do it with an equitable tax reform, which also builds back greener. This implies reducing the cost of business and employment. Instead of a higher minimum wage, which will eliminate over a million jobs, the federal government should increase the earned-income tax credit. That would reduce poverty without hurting small enterprises.

To build back better sustainably, government needs to eliminate subsidies to pollution and to land value. The "green new deal" should focus on making polluters pay the social cost of the damage they cost. When polluters do not pay compensation, in effect they are subsidized, not paying the full social cost of their enterprise. Slapping a tax on environmental damage would bring in revenue rather than imposing an arbitrary cost on the economy.

The mother of all subsidies is the increase in land rent and land value caused by the public goods provided by government. Public goods, such as security, streets, and schooling, make locations more productive and more attractive. That increases the demand to be located there, raising the land rent and land value. With public goods funded by taxes on labor and enterprise, land owners receive the higher values as an implicit subsidy. This increases the cost of housing and increases economic inequality. To eliminate this subsidy to the wealthy, make the owners of real estate pay the rent gains back to the government. That would tax the wealthy much better than a complex and unwieldy wealth tax.

An historical example of building back quickly was San Francisco after the earthquake and fire of 1906. There was no income or sales tax back then; taxes were on real estate, and with the buildings destroyed, in effect taxes were on land value. To make the property tax worth paying, owners quickly rebuilt. The same would happen today if the taxes were on land value instead of on labor, goods, and enterprise.

Radical tax reforms will not happen right away, but understanding the optimal tax reform provides the best direction for change. Let us first increase the earned income tax credit. Compensate those who are suffering losses from the lock-downs. Tax polluters. And start reducing the subsidy to real estate, such as no longer being able to deduct mortgage interest payments from taxable income. Push the states to tax land value rather than buildings by keeping the tax deduction for property taxes on land value, but eliminating the deduction for property taxes on building value.

The public needs to understand how to build the economy better with efficient and equitable tax reforms. But government will not act until the public understands.

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FRED E. FOLDVARY, Ph.D., (May 11, 1946 — June 5, 2021) was an economist who wrote weekly editorials for Progress.org since 1997. Foldvary's commentaries are well respected for their currency, sound logic, wit, and consistent devotion to human freedom. He received his B.A. in economics from the University of California at Berkeley, and his M.A. and Ph.D. in economics from George Mason University. He taught economics at Virginia Tech, John F. Kennedy University, Santa Clara University, and San Jose State University.

Foldvary is the author of *The Soul of Liberty*, *Public Goods and Private Communities*, and *Dictionary of Free Market Economics*. He edited and contributed to *Beyond Neoclassical Economics* and, with Dan Klein, *The Half-Life of Policy Rationales*. Foldvary's areas of research included public finance, governance, ethical philosophy, and land economics.

Foldvary is notably known for going on record in the *American Journal of Economics and Sociology* in 1997 to predict the exact timing of the 2008 economic depression—eleven years before the event occurred. He was able to do so due to his extensive knowledge of the real-estate cycle.