THE PROGRESS REPORT / 2005

Land-Value Taps are Better Than Neutral

By Fred E. Foldvary

Public revenue from land value or land rent is the most efficient way to pay for public goods such as security, streets, and parks. It does not burden an economy to tap land value to finance civic goods. Besides being efficient, land-value taps are also equitable, because civic services pump up land value, and the tapping of this value pays back value received. Another source of equity for land-based public finance is that it does not violate the Creed of the Market: ***to the creator belongs the creation***.

But land-value taps are better than merely being efficient and equitable. Taps on land rentals actually improve the productivity of an economy. This beneficial effect goes beyond reducing the burden of other taxes.

If markets were perfect, rent-based public finance would indeed be neutral, not hurting the economy but also not helping it, considering only the revenue. Perfect markets imply complete knowledge and zero uncertainty. Lenders would know the exact credit risk of each borrower and could charge a risk premium on loans reflecting this risk. Those who buy financial assets would know the future prices with absolute certainty.

Such a world cannot exist. An axiom of economics is the ubiquitous and unavoidable presence of uncertainty, because the economic future is unknowable, and because economic values are subjective and can be fully known only by the individual economic actor.

Uncertainty affects land in two ways.

- First, those who bid to buy land for speculation are not certain what its future price will be. Land speculation is the purchase of land in order to gain from an increase in its price. We can't know the future, but we can guess. The variables involved in guessing the future price of land include how land prices are affected by population growth, increases in commerce and development, changing technology, governmental civic works, changes that can be brought about by nature, and very importantly, the expectations of other speculators.

Since each of these variables is uncertain, the expected future value of land depends on how much weight the speculator attaches to each variable. Some speculators expect land value to zoom up, and other are more pessimistic. In the real-estate market, the most optimistic person wins the bid and buys the land. But quite possibly, he could be wrong about the future price of land. He holds land waiting for the price to go up, while unexpectedly, development goes elsewhere. His land holding meanwhile makes those who actually want to use land go to less productive areas, creating a less efficient use of land.

- Another source of uncertainty is in the credit or lending markets. Banks and other lenders guess about the credit-worthiness of those they lend to, but they can be mistaken. Poor

> folks are less likely to pay back loans, and so there is more uncertainty lending to poor folks than to rich folks. Even when the loan is secured by real estate, it is costly to repossess property and put it on the market for sale. Perhaps also the property value could fall, and the buyer could just walk away from the property. When banks do make such loans, it shifts the uncertainty to the bank, making banks in general more vulnerable to a recession.

Two geoclassical economists, Mason Gaffney and Nicolaus Tideman, have analyzed these market uncertainties, and concluded that using land rent for public revenue reduces this uncertainty by lowering the price of land. For goods in current production such as cars, taxes raise the purchase price, because it is added to the cost of production. But the cost of production of land is absolute zero, and no new land can be produced. Since the tapped site holder keeps less of the rent, a new buyer bids less to get the land, and the site value falls.

With much of the site rental tapped for public revenue, less is left as profit for the land speculator. Land has value because of the rent it gets. Less rent, less value. The optimistic land speculators become less inclined to buy land for gains, because the gains are too tiny.

With the price of land driven down to a small fraction of untapped land value, those with lower income and greater uncertainty of paying back loans can better obtain land. Also, the fluctuation of real estate prices is mostly about the land, not the value of buildings. So markets for loans for real estate are less uncertain, and more properties are sold to low-income users rather than wealthy speculators.

By driving down the price of land to a small fraction of its untapped price, land-value taps reduce market-hampering land speculation that postpones the optimal development of land. Vacant lots in the city get built up, and there is less subsidized sprawl to the urban fringe. There is more public transit in the city center and less wasteful destruction of wildlife habitat.

Milton Friedman, a leading free-market economist, stated that a Henry George "tax" only on land value is the "least bad" tax. But as shown by Gaffney and Tideman, tapping the site value not only does not harm, it can do good. Land-value taps are better than neutral.

Site rentals keep gushing out from land no matter what, and if left untended, they go and flood the economic landscape. Land rental is like the Mississippi River by New Orleans. It needs to be properly channeled in order to avoid over-flooding. Land prices over-flood when they are driven too high by overly optimistic land speculators with good credit ratings. When site rentals are channeled for public revenue, this damage is averted. Economic efficiency requires tapping land value for public revenue, above and beyond their use for public goods.

-- Fred Foldvary