

# The Libertarian Perspective

## The route to economic justice?

Fred E. Foldvary

CAN economic justice be achieved by shifting governance to private communities, including proprietary communities (like shopping centres and hotels), civic associations (such as condominiums and cooperatives), and land trusts? They can, claims Dr Foldvary, when the rent generated by communities is ring-fenced to finance shared services.

**Dr. FRED FOLDVARY**  
*teaches economics at Santa Clara University, California. His books include Public Goods and Private Communities and Dictionary of Free Market Economics*

Economic justice occurs when there is no restriction on honest and peaceful enterprise, employees keep the earnings that originate in labour, and people share the gains that originate in land. Human beings should be equal as self-owners and thus fully own their labour, but since self-ownership does not extend to land, its economic benefits, manifested in rent, should be shared via public finances, with no tax burden on labour or capital.

These propositions have been widely presented in the works of Henry George and the literature derived from his thought (see Feder 1996, Foldvary 1999, Gaffney 1994, George 1879, Tideman 1994). The thrust of Georgist policy reform has been to shift taxation to site rents. But, argues the author, if such a change faces political resistance, then possibly the path of least resistance would be the privatisation of communities. This process is already occurring world-wide. The formation of private communities may already be the largest privatisation movement on the planet.

ECONOMISTS have identified land, labour, and capital goods as the factors, the resource input categories, of production. Land includes space, which within any jurisdictional boundary has a fixed extent and immobile location. This fixed supply results in the capitalisation of positive externalities into site rent. The advantages of a location, whether natural as with climate or produced as with transit, increase the demand to be located there, and thus raises the rent that tenants are willing to pay. If a private party can collect this rent, it provides the means to provide the produced advantages. Private communities can and do thereby efficiently provide public goods, as they generate rentals that in turn finance the goods.

A hotel is a prime example of a proprietary community financed by rentals. The hotel provides public goods similar to those of a city government. There is public transit in the form of elevators and escalators. Stairways and corridors are the equivalent of streets. The hotel lobby is a like public park, and the administration provides security, fire protection, recreation, and other civic services. Large hotels also have shopping centres, and some provide external transit to airports. Such similarities to government services were analysed by Spencer Heath (1956) and Spencer MacCallum (1970) in their pioneering works on proprietary communities.

Whereas a typical city is financed by a multitude of taxes on income, sales, real estate and other property, business permits, and various fees and fines, a hotel is mainly financed from the room rentals. As private firms operating for profit in a competitive market, hotel managers seek to provide services efficiently. They therefore practice marginal-cost pricing. The marginal or extra cost of carrying one more person in an elevator is trivial, more than what it would cost to collect as a fee. Hotels therefore do not charge the guests for the use of the elevators or escalators. The gratis transit service also makes the hotel more useful for the guests, since they can be mobile between their rooms and the hotel facilities without having to pay a fee for each trip. The vertical transit is financed from the room rentals, since a hotel with an elevator is more desirable than one with only stairs.

Likewise, a hotel's exercise room and swimming pool are gratis to guests paying for rooms; the marginal cost for these is low as well. In contrast, room service is paid with user fees, since the marginal cost of the meal and delivery is high. Thus the hotel has user fees for individual services with a significant cost, with other services paid from the room rentals. The equitable and efficient public finance for a city consists of the same principles: user fees and rental charges. For example, mass public transit would be gratis to the user, paid for from the collected site rents.

Civic associations also use the efficient method. Consider a condominium, where each unit is owned individually and the associated

unit co-owners each own some percentage of the common elements such as the landscaping. Typically in the USA, the percentage interest of each unit constitutes both its voting share and its percentage of payment for the associations spending. Suppose there are 100 units, each with a one percent interest in the commons. If the budget is \$100,000 per year, each unit pays \$1000 per year.

This assessment is a fixed amount per year, and therefore independent of the unit owners personal property, income, or spending. Thus, no marginal cost is imposed on the owner-member. Moreover, the percentage interest of a member is related to its share of the site value, as a larger and better located unit typically has a larger percentage interest. Thus, the condominium assessment works very much like, and is for practical purposes, a site-value charge. Condominiums are implicitly Georgist communities.

Other types of private community structures work similarly. In the USA, a residential or homeowners' association is similar to a condominium, except that the association itself might own the common elements as a corporation, the unit owners being members. When a unit is sold, the new owner must belong to the association. The effect is the same, as the members pay assessments for the common elements, such as parking areas, parks, recreation, and community meeting rooms. Some associations own their streets and provide security, including the guards or locks at the entrances of gated communities. Some associations include commercial property.

Associations having membership rather than percentage interests may charge the members as they wish, but in practice, the assessments are either equal flat charges or based on the property values. Although some do not charge strictly by land value, the general effect is similar to that of condominiums, as any member's additional income, spending, or personal property is not penalised by taxation.

Land trusts are more explicitly land-value based, as typically the trust has leaseholds of land, and the rental pays for the services of the community. In Arden, Delaware, a village of some 500 inhabitants, the trust also pays the real-estate tax that is imposed on the value of the whole property, so the leaseholder can improve his property with no tax penalty.

In economics, such organisations are generally called "clubs", and their goods are "club goods". The efficiency of private clubs is due to their voluntary nature and to competition. If there are many hotels and condominiums in an area, the inefficient ones will have higher costs for the similar services. So because customers, guests, and members have a choice among clubs, the clubs have an incentive to be efficient. Moreover, in a democratic association, there will be voice pressure at board meetings when things go wrong, and the board can be replaced. In a for-profit

corporation that operates hotels or shopping centres, ideally the profit-seeking motive would minimise costs. That is why private communities tend to use efficient single-tax-type financing by benefit-based rental charges rather than basing fees on income or personal wealth.

EBENEZER HOWARD developed a theory of civic associations in *Garden Cities of Tomorrow* (1902). The basic idea was a "voluntary plan of public finance" using leaseholds of land: "One essential feature of the plan is that all ground rents, which are to be based upon the annual value of the land, shall be paid to the trustees, who, after providing for interest and sinking fund, will hand the balance to the Central Council of the new municipality, to be employed by such Council in the creation and maintenance of all necessary public works – roads, schools, parks, etc." (1902, p. 51). Howard credits Thomas Spence with having thought of the concept in 1775 of assembling landed property and letting it out on leaseholds (pp. 119-23). The town would issue a prospectus indicating the scope of operations. A Board of Management, elected by leaseholders, would govern the city. The extent of town services would be limited by the willingness of leaseholders to pay the rents (p. 91). To a large extent, civic associations operate the way Howard envisioned.

### **Governance of private communities**

To analyse the voluntary nature of private communities, we need to distinguish their constitutional from their operational levels. A constitution is the supreme law of an organisation, on which all other laws or rules are based. In a civic association, the constitution can be a master deed, which all members explicitly agree to abide by when they sign on as members. The master deed sets forth how the board is elected and what the powers of the board are. The operational level consists of the annual budget and rules the board enacts, by their authority as provided by the master deed.

The earliest known use of deed related associations took place in the mid 1700s in London. Lord Leicester established a park in Leicester Square, and adjacent property owners agreed to an assessment to fund it, which benefited them by increasing their property values (Frazier, 1980, p. 96). Another private community in Great Britain was Victoria Park, near Manchester, which was laid out in 1837 and operated privately until 1954. The sale of its lots carried with it "certain conditions, the 'laws' of the Park, which would protect its amenities" (Spiers, 1976, p. 13). Besides annual "rates," Victoria Park levied tolls on some of its roads.

A member may object to the particular budget the board has chosen, but his membership is still voluntary, since he is not forced to join the association in the first place. The voluntariness of a private community is at the constitutional level. When one joins, one agrees to abide by the constitutional provisions, even if he does not like some particular

operational decisions. In residential associations, the master deed often includes covenants limiting what a member can do with his property. It is the responsibility of the prospective member to read the master deed and bylaws carefully, and not join if he thinks these are too restrictive or costly.

In today's practice, private communities are not purely private, as they operate under governmental law. No country today has a purely free market. To some degree, government prescribes how private communities are organised and operated. The operations of private communities are also affected by taxation, which puts them at a disadvantage to governments. For example, the assets, both real and financial, of a private community are taxed, whereas government municipalities are not taxed by higher-level governments. There is also usually no tax credit for substituting private services for those provided by the state.

In St. Louis, Missouri, there are privately owned neighbourhoods where the members own the streets. They pay to maintain the streets, saving the city government the expense, but they still the same taxes to the city as neighbourhoods which are not private. This creates a disincentive to privatise, since it results in an additional expense. The fact that private place have persisted in St. Louis despite this tax inequality demonstrates the advantages of private communities, as they provide better protection from crime and a better social environment. If the members could take a tax credit for the expenses saved the city, then private and governmental neighbourhoods could compete on an equal financial basis, and most likely there would be many more private places.

**Private communities world-wide** IN JUNE 2000 the Gutenberg University in Mainz, Germany, hosted a conference on "Private Urban Governance". The conference demonstrated both the rapidly expanding growth of private communities world-wide as well as the growing academic interest in these. Most of these developments were in the USA during the 1970s and 1980s, but during the 1990s the concept mushroomed world-wide. More than 40 million Americans live in common interest developments (CIDs) such as condominiums, cooperatives, and homeowners' associations. They are often referred to as "gated communities", but most do not have walls or gates. CIDs and other private communities are rapidly spreading even in formerly socialist countries such as Russia and China.

An impetus for the growth of private communities is to provide public goods beyond those provided by government. In the US, private communities offer greater amenities such as recreational facilities, as well as greater security. In Russia, gated communities are a response to the failure of government to provide adequate security. Many governments

favour private communities as a way to shift some of the expense of providing public goods to the local residents.

While homeowner associations have been criticised as undemocratic for not giving non-owner tenants a voice, in the Reston Association in Virginia, each resident-tenant has a vote for the board of directors, each owner also having a vote, thus an owner-occupant having two votes. Even when tenants do not vote, they can still have a voice. In the Fort Ellsworth condominium in Alexandria, Virginia, renters are able to participate in committees, and if they are the head of a committee, they may sit as non-voting board members and take part in the board discussions. Tenants may also attend board meetings and voice their concerns. In the village of Arden, Delaware, the land is owned by a trust, but the village is governed democratically by town meetings, and the leaseholders also elect the board of assessors (Foldvary, 1994).

CIDs world-wide are growing in response to both greater wealth and inadequate governmental public goods, especially security. In Argentina, while the country suffers from an economic crisis, Noredelta, the largest housing project in the country's history, begun in 1999, is being developed as a private community of 1600 hectares with a projected population of about 100,000. It will include sports facilities, schools, shops, restaurants, and office buildings. In South Africa, gated communities for the wealthy are growing rapidly in response to increased crime, but they also provide amenities such as swimming pools and tennis courts.

At the German conference, Prof. Chris Webster of Cardiff University, UK, presented his study of private communities in China (Webster, 2002). One of these, Bai Bu Ting, is an entirely private community covering one million square meters, currently housing 30,000 residents, with developed infrastructure for up to 200,000. The community provides a full range of urban services, including a neighbourhood charity. The only involvement of the local government was to provide the land. This may already be one of the largest proprietary-community projects in the world.

Many other private communities have been constructed in China. For example, in Wuhan in Hubai Province, about 70% of the 5 million urban residents now live in proprietary communities, half of these being partnerships with estate management firms. China has about a 400 million urban population, and if the cities in China have privatised in a way similar to Wuhan, then some 280 million people could be living in owner-owned associations or corporate-owned proprietary communities. Another example of the privatisation trend in China is a 100,000 population estate in Beijing previously owned by the local government and financed by various central government ministries for housing their employees. With the reforms of the 1990s, the homes were sold (at rock-bottom prices) to the employees and their families, who then employed a private company

to operate the governance functions once performed by the local government (Webster, 2002).

Another presentation at the German conference was "The Purple Jade Villas: a Golden Ghetto in Red China" by Prof. Guillaume Giroir of the University of Orléans, France. This community, a residential complex of 400 luxury villas north of Beijing, demonstrates similarities with gated communities worldwide, but its relationship within the metropolitan area was found to be ambiguous. The author concludes that this gated community appears to be privatised and segregated from the larger community, but it shares many of the problems of the metropolis, such as environmental issues, insecurity, and urban sprawl. The Purple Jade complex provides recreational facilities, including a club house, swimming pools, green spaces, tennis courts, golf, and a winter ice rink. Residents include both Chinese and foreigners. Security services include a wall surrounding the community and armed guards. The houses are priced from US \$400,000 to \$1,600,000, the land still being nominally owned by the government (Guillaume, 2002).

**Global use of site rents** THE USE of site rent for public revenue and the provision of public goods is both efficient and equitable. It is efficient because it imposes no burden on additional production and investment. It is equitable because the payment of rent is based on the benefits of the local amenities, including infrastructure and security. Private communities, competing in a market, have the incentive to provide public goods to their members efficiently, and in relation to benefits. The communities are financed by property assessments rather than charges based on income or sales.

The rapid world-wide growth of private communities represents a real-world increased use of site rents to finance public goods. Reformers who seek to promote greater efficiency and equity in public finance could, in addition to advocating shifts in government policy, promote policies that would better facilitate a shift to privatisation in the provision of public goods.

To place private communities on an equal financial setting with governmental jurisdiction, there needs to be a legal provision for the formation of civic associations with the power to replace governmental public goods with those provided and financed by the association. There would also need to be a provision to reduce the tax liability of the community members for the savings to the local government for not having to provide services such as parks, streets, and security. This reduction in taxation, replaced by the rental assessments, would at the same time shift public revenue from taxing income and sales to charges based on site value. A shift in governance to private communities could well be a politically palatable way of shifting public revenue to land rent.

## Bibliography

- Feder, Kris (1996). "Geo-economics", in Foldvary, Fred (ed.), *Beyond Neoclassical Economics: Heterodox Approaches to Economic Theory*, Aldershot, UK: Edward Elgar.
- Foldvary, Fred E. (1994), *Public Goods and Private Communities*, Aldershot, UK: Edward Elgar.
- Foldvary, Fred E. (1999), "The Ethics of Rent", in *Land-Value Taxation: The Equitable and Efficient Source of Public Finance*, Kenneth C. Wenzer (ed.), Armonk, NY: M.E. Sharpe.
- Frazier, Marc (1980), "Privatizing the City", *Policy Review* 12 (Spring).
- Gaffney, Mason (1994). "Land as a Distinctive Factor of Production", in Nicolaus Tideman (ed.), *Land and Taxation*, London: Shephard-Walwyn.
- George, Henry (1879 [1975]), *Progress and Poverty*, New York: Robert Schalkenbach.
- Giroir, Guillaume (2002), "The Purple Jade Villas (Beijing): a golden ghetto in Red China", Paper presented at the International Conference on Private Urban Governance, June 5-9, 2002.
- Glasze, Georg, ed. (2002). *International Conference on Private Urban Governance, June 5-9, 2002: abstracts*, Mainz: Institute of Geography, Johannes Gutenberg Universität. <<http://www.gated-communities.de>>
- Heath, Spencer (1957), *Citadel, Market and Altar*, Baltimore: Science of Society Foundation.
- Howard, Ebenezer 1902 [1965], *Garden Cities of Tomorrow*, Cambridge: The M.I.T. Press.
- MacCallum, Spencer (1965), "The Social Nature of Ownership", *Modern Age* 9, No. 1 (Winter 1964/5).
- MacCallum, Spencer (1970), *The Art of Community*, Menlo Park: Institute for Humane Studies.
- Spiers, M. (1976), *Victoria Park: A Nineteenth Century Suburb in its Social and Administrative Context*, Manchester: Cletham Society.
- Tideman, T. Nicolaus (1994), "The Economics of Efficient Taxes on Land", in Nicolaus Tideman (ed.), *Land and Taxation*, London: Shephard-Walwyn.
- Webster, Chris (2002), "Private Communities and China's Dual Land Market." Paper presented at the International Conference on Private Urban Governance, June 5-9, 2002.