

The Pre-Existing Land Value Problem

A land-value tax (LVT) will decimate people's property values, so property owners won't want an LVT without an additional solution. Here's another solution.

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The major obstacle to shifting public finances from economy-crushing to prosperity-boosting is pre-existing land value. The payment of a community rent by landowners or tenants, or land-value taxation (LVT), would reduce the value of land. To some degree, the decrease in land value is offset by an increase in land rent due to greater production and growth, but if that extra rent is also tapped for public revenue, the selling price of land would plunge to near zero. For a pure example, suppose there are no taxes at all, and a plot of land has a selling price of \$100,000. In this pure example, public goods are paid for from a national government grant, so that the landowner does not pay for the local civic services. Now introduce a tax of 100 percent of the land rent. The selling price of land is based on the rent, so if the title holder keeps no rent, the price of land plunges to zero.

Suppose also that all the income of this title holder comes from the rent of this plot of land, plus tax-free municipal bonds. He rents out the land to a tenant, who pays \$5,000 per year in land rent to the landlord. The tax shift would eliminate this income and result in a loss of \$100,000 of asset value.

A prosperity tax shift could be politically facilitated with compensation to those with net losses. In this example, the government would give the title holder bonds that pay interest at \$5,000 per year. With a general market rate of interest of 5 percent, the bonds would have a market value of \$100,000. With this compensation, the landowner would have no net loss.

He might complain that the rent of the land would have risen, aside from general inflation, while the bond's inflation-adjusted interest payment stays the same. The expected increase in rent would increase the present land value, and if the landowner is only compensated for the lost rent, his decrease in land value would be greater than the capitalized price of the bond. Hence complete compensation would be based not on the current rent but on the current land value at the time of the shift.

Henry George, the prime historic advocate and theorist of rent-based public finance, argued against compensation for landowners. He argued that landowners were receiving income from a source that is not properly theirs. The same argument can be made for liberating slaves. The owners were stealing wages that properly belonged to the slaves. However, the British did compensate the slave owners when they abolished slavery. Compensation was not morally required, but it made the liberation politically feasible. Likewise, Taiwan compensated landowners with bonds when it enacted land reform and LVT. Compensation would be a way to overcome political resistance to a prosperity tax shift.

The pre-existing land value problem becomes worse when there is a mortgage on the land value. Suppose in our example that the title holder had bought the plot for \$100,000 and paid a mortgage interest of \$5,000 annually. All the rent goes to pay the mortgage interest, and now comes the government to slap on a \$5,000 tax on income he does not have. Some have proposed that the bank that lent the \$100,000 pay the tax, but that could make banks insolvent. Compensation provides the title holder with the funds to pay the mortgage. Alternatively, the land-value mortgage could be bought by the government.

Landowners would only be compensated for their net loss. Most landowners are also workers who earn wages, and they are savers, investors, and entrepreneurs who receive income from interest, dividends, royalties, and business profits. The abolition of taxes on these earnings would offset the increase in taxes on their land holdings. The typical homeowner would have a net gain, because the community rent payment or LVT would not apply to the value of buildings and other improvements, and taxes on wages and goods would be gone.

Many advocates of land value taxation have proposed that the government buy the land or compensate title holders. An example is the 1800s economist Leon Walras, famous for his theory of general equilibrium. If compensation can facilitate and speed-up a prosperity tax shift, let's do it. If the slave owners of the old South had been compensated for the liberation of their slaves, it would have been much cheaper than the costs of the Civil War. Are we to suffer from perpetual tax slavery because of a transition problem?

Of course compensation would create a huge increase in government debt and interest expense. But the economy would be so much more productive, and growth so much greater, that an ever increasing income from rent would enable the government to reduce its borrowing and eventually buy back the bonds. The elimination of harmful taxes would also reduce poverty and enable workers to finance their own retirement and medical care, greatly reducing government expenses.

The alternative to an efficiency tax shift is much worse than the LVT transition problem. The USA, Europe, Japan, and other developed economies will continue to have colossal deficits and also money expansions that will end ten years from now in a financial crisis. Unable to borrow any more funds except from central banks, governments would have to resort either to hyperinflation or a default on their debts. The stock market will plunge worse than in 2008, as people take their money out of collapsing banks, fiat currencies, and companies, to buy tangible goods such as gold.

The political choice is therefore a prosperity tax shift that would increase government debt but provide the funds to buy it back, or else an economic plunge that would destroy the value of government debt. Unfortunately the leading forums such as the *Wall Street Journal*, *New York Times*, and *Washington Post* have not even discussed this choice. Their editorial default will help cause the economic default.

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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.

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