

WHAT DO YOU KNOW ABOUT TAXES? WRONG!

BY FRED FOLDVARY

Two economists at the University of California at Berkeley, Emmanuel Saez and Gabriel Zucman, have written a book, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*. A review by William G. Gale in the Brookings web site (Oct. 23, 2019) is titled "Saez and Zucman say that everything you thought you knew about tax policy is wrong." Saez and Zucman also wrote an op-ed in the New York Times, Oct. 11, 2019, titled "How to Tax Our Way Back to Justice". It is subtitled "It is absurd that the working class is now paying higher tax rates than the richest people in America."

The authors calculated how tax burdens are distributed among income categories. They pointed out that the United States tax system is a regressive one, if we compare the richest 400 adults to the total tax rates paid by low-

income wage earners, despite the progressive graduated income-tax rates. One third of all taxes is paid to state and local governments, and sales taxes are especially regressive, taxing the poor proportionately higher. Lower-income families also pay substantial amounts of payroll taxes.

Saez and Zucman helped to craft presidential candidate Elizabeth Warren's proposed tax on wealth. They

argue that tax flight and avoidance can be dealt with by taxing companies headquartered in the United States on their less-taxed income abroad. The United States could also tax foreign companies' sales in the United States.

But such analysis overlooks the theory of optimal public finance. One foundation of economic analysis is the "law of demand." Higher costs and lower gains reduce the quantities... (cont'd on pg. 7)



Senator and 2020 Presidential hopeful, Elizabeth Warren

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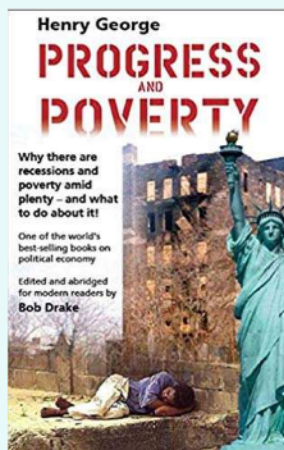
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Solving the "Affordable Housing" Problem with Land Value Tax (cont'd from pg. 3)

The exchange recounted above highlights the difficulties in trying to explain the idea to someone who thoroughly understands what land value taxes could achieve but rejects them nonetheless on other grounds. Reflecting on it, I see where my friend was coming from: Land value taxation should, in theory, raise total wages and greatly increase the housing supply; but people should be mobile too, even including nonresidents who come in to elbow out poorer ones for the benefits the system provides. In Minneapolis where I live, we have seen significant growth in high-end housing in recent years but very little for the poor.

So what can a local government do to ensure that land value taxes help the people who need help the most, rather than high-income newcomers? I propose two answers:

- Inclusionary zoning; and
- Modular construction

Inclusionary Zoning

Inclusionary zoning, also called "housing mandates," requires developers of new properties to set aside a certain number of units for low-income tenants. These tenants would need to submit documentation to qualify for the units. In a post I wrote for the Robert Schalkenbach Foundation's blog I endorsed a recommendation for improving inclusionary zoning by requiring tenants to renew their qualifications on a periodic basis. That way, the units would turn over more frequently and that would ensure that low-income tenants had opportunities to live in them.

A problem with inclusionary zoning is that developers tend to dislike it because it forces them to sell their construction to landlords for less than the market would normally allow. An article on Minnesota Public Radio's website lists some examples of how developers push back against inclusionary zoning:

- Developers will shift their focus to updating older housing that they can sell at market rates, and
- They will instead focus on the suburbs, which place fewer

restrictions on development.

Modular Construction

If, as developers say, construction costs ruin the viability of inclusionary zoning, they could embrace an obvious alternative: reducing costs by shifting to modular-housing technology.

The concept of assembly-line homes is not new, but it lacks substantial backing in the United States. Investors appear to be changing their minds, however. Thanks to housing demand and a shortage of construction workers, times are changing, and the scale is achievable. One Minnesota housing company cranks out complete houses in just ten days. Its factory floor is the size of two football fields, and employees work on several homes at once, installing even pipes and wires as they go.

The savings in the cost of this construction as compared to that of ordinary on-site construction are significant, up to 40 percent per project. These kinds of savings are extraordinary when apartment buildings can cost more than \$10 million. Undoubtedly, then, it should be very easy to build more affordable homes for lower income residents with cheaper construction costs.



Market Forces Alone May Not Be Enough

Policies designed to alleviate poverty always seem to have self-defeating consequences, even when they rely on market forces. This is because access to the market is the problem in the first place. A strong example of this is relaxing zoning regulations, or "upzoning." Upzoning should enable developers to build towering, affordable apartment buildings. In at least one example, though, it just increased property values and didn't affect supply at all. Nor does upzoning solve the migration problem outlined above.

In the case of applying land value taxation locally in the United States, high mobility amplifies these kinds of consequences, and the beneficiaries may be the people who need help the least, since wealthier families tend to be more mobile than the less well-to-do. Rather than letting land value taxes become the victims of their own success, governments can use inclusionary zoning and promote modular construction to shield the indigenous poor. These policies can work together to keep poorer residents in their communities and prevent high-income workers from moving into the condos developers would otherwise gladly build for them.

There are no good arguments against land value taxes because they drain monopoly incomes and raise productive activity. However, advancing them requires winning over social-justice advocates who prioritize keeping the poor near urban centers. Coupling land value taxes with inclusionary zoning and modular construction can win over that constituency.

What Do You Know About Taxes? Wrong! (cont'd from pg. 4)

of goods produced and bought. The three ways that quantities are reduced: the taxed items can shrink, hide, or flee.

A global approach to taxation, taxing everything that moves, world-wide, will indeed reduce flight. But the other two means of quantity reduction still occur. Production and employment will lessen, as the higher-cost enterprises shut down. And economic activity will hide, will go underground, as indeed already happens throughout much of the world. Moreover, if the US government taxes everything related to the USA, there will be a high demand for tax havens. Companies and their jobs will flee, and their sales to the USA will shrink or hide. High taxes reduce entrepreneurship and they reduce honesty, as tax cheaters gain and honest payers lose.

In his book review, Gale writes that Saez and Zucman "challenge seemingly every fundamental element of conventional tax policy analysis." Yes, they do calculate taxes in ways different from mainstream and official methods, but they do not challenge the law of demand.

Therefore the analysis of Saez and Zucman is not radical, in the sense of going to the root of the economic, ethical, and governance aspects of taxation. The principle of optimal public finance policy was set forth by Frank Ramsey, and is named the Ramsey Rule: tax first the items that are the least elastic in supply or demand. Thus, tax first the items which do not flee, shrink, or flee at all.

One item with an inelastic demand that is urgently needed is life-saving medicine, and it would be immoral to tax-punish sick people facing death. The moral alternative is thus on the supply side. The American economist Henry George identified the supply which could be taxed without economic damage: land value or land rent. Tax land, and it will not flee. Land also does not shrink when taxed.

What about the problem of justice? Much of the value of land comes from the public goods provided by

government, paid for with taxes on goods and labor. Worker-tenants get double billed, paying both taxes and higher rent, while landowners get the subsidy of higher property value. How is this just? The remedy is to not tax labor and instead to only tax land.

And land cannot hide. The landowner can hide the title, but that does not matter. The tax bill is sent to whomever possesses the title. The landowner also cannot hide the amount of land value, as its market value is not dependent on his private calculation but is calculated by professional real estate assessors and appraisers.

So a tax on land value cannot be dodged, and that solves one of the problems raised by Saez and Zucman. What about the problem of inequality? Most of the land value is owned by the rich, including corporate land owned by shareholders. The ownership of real estate is highly correlated with wealth

and income.

How much revenue could a land-value tax obtain? A good indicator is by comparison with Australia. There, the calculation is that land rent is one-third of national income. (See The Taxable Capacity of Australian Land and Resources by Terry Dwyer.) With ten times the population density, land rent should be at least that portion in the USA, or about \$7 trillion per year. And if other taxes are eliminated, the rent would increase much more. How much? Nobody knows, but economist Mason Gaffney has shown that there would be a "quantum leap" of greater production and therefore that much more land rent.

So, is everything you knew about taxes wrong? That seems to apply to economists who fail to take economic logic to its ultimate public-finance Ramsey-George conclusion: don't tax anything that moves. Tax what cannot flee, shrink, or hide, namely, land.

THE EQUAL RIGHT OF ALL MEN TO THE USE OF LAND IS AS CLEAR AS THEIR EQUAL RIGHT TO BREATHE THE AIR - IT IS A RIGHT PROCLAIMED BY THE FACT OF THEIR EXISTENCE. FOR WE CANNOT SUPPOSE THAT SOME MEN HAVE A RIGHT TO BE IN THIS WORLD AND OTHERS NO RIGHT.

Henry George

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