PRIVATIZING LAND WITHOUT GIVEAWAY

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Chair: Professor Nicolaus Tideman

Excerpt on privatizing land

Few now question that the land of the Soviet Union belongs to the whole people, through their governments. It is public domain, just like Federal and state lands in the U.S., and Crown lands (Federal and Provincial) in Canada. (We do not here address the tortured topic of which constituent government owns what lands, a matter for citizens of the lands at issue to decide for themselves.) The question here is why and how to assert the common ownership of land by having government collect land rents to support its public functions.

A. Financial Reasons to Reserve Rent as a Tax Source

A simple, fast method of privatizing public land is selling fee simple title to the highest bidders, free and clear of reserved sovereign taxing rights. Selling is not abandoning or giving away the public equity in land, but exchanging it for cash up front. Why not sell, get it over with and let the market work its magic from there?

Many American economists push this policy when advising how best to privatize or lease[2] public domain lands at home, especially since 1980. Without denying the prior

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[1]Edited collection to be published 1991, edited by Nicolaus Tideman and Adele Wick.

[2]In respect to writing mineral leases on the OCS (Outer Continental Shelf) the issue presents itself in the question of whether to demand payment up front (the "bonus bid") or over time (delay rentals and royalties).

public claim on ground rent, they sincerely see cash-up-front as the best way to assert the public claim, and thenceforward free the market from the meddlesome hand and irrational mind of government.

There are, however, many reasons to reject the policy of cash sales without credit or other deferred payment.

1. An entire nation cannot be sold off quickly at other than fire-sale prices. Mass privatization is a way of securing the worst possible bargain for the public selling the land.

Selling even a large bloc of land anywhere depresses prices, unless the proceeds are concurrently reinvested in nearby lands. A massive nationwide sale could only be a giveaway. Normal yearly turnover in the U.S. land market is 3-4 percent of parcels, and much less than 3 percent of value (because small parcels turn over faster). Most of even that small turnover is zero-sum, buyers being financed by sales of what they owned before. Net movement of money in or out of land is a small percentage of total value turned over, and a minuscule share of total land value.

Dumping all land in any short period, when that means finding new buyers to put new money into land titles, is unthinkable. The first small share of land sold would soak up all available capital funds, leaving none to buy the rest, let alone to finance development, improvement, and working capital.

Some economists point out there are plenty of hoarded private rubles to spare. Land sales, they believe, would "soak them up," thus in one stroke forestalling inflation, rewarding past abstinence, honoring a species of national debt, and getting a good price for land. That solution is illusory. Such rubles are just paper, not real wealth. To soak up the money and honor and retire the debt, the rubles received would have to be destroyed. Following that operation the seller would have no lands, no rubles, and no source of tax revenues.

The state would have reduced its "debt," it is true, if outstanding rubles be properly regarded as public debt. However, the conditions of the exchange would be such as to downvalue the lands given, and revalorize and validate the "debt," much to the disadvantage of the state and the bulk of citizens it represents. It is hard to see why the past generation had any right to alienate lands which are the birthright of present and future generations under any circumstances, let alone such disastrous ones.

Alternatively, after the sale, government might spend the paper rubles, but then it would not be repaying the "debt" they represent. The net effect on price levels would be much like financing government with newly printed money. In a nation perched on the edge of major inflation, that seems unthinkable. In spite of the suffering, it would not raise the real price fetched for land. Real prices are paid in real labor and real goods.

Germany faced the same problem in 1948 as it struggled to emerge from years of suppressed inflation and reconsitute a workable market economy. The currency reform of that year simply repudiated the old marks: Draconian perhaps, not fair in every case, but better than any alternative and highly effective. It is doubtful if the ensuing Wirtschafstwunder would otherwise have occurred.

2. In a massive general land sale, most land would be bid up by a small number of buyers with surpluses of "patient money," many of them looking toward use or resale in the distant future. These buyers are the kind stigmatized as "land speculators," for their traditional indifference to highest and best current use of land.

To be sure, standard neo-classical microeconomic theory today hardly allows for such market failure. This theory is based on a priori deduction from unreal axioms selected to idealize market performance. Indeed, standard-brand theories hardly allow the existence of land as a factor of production with distinctive qualities, and are of limited use in predicting real behavior, and especially in finding departures from perfection.

The evidence of land market performance may be found instead by looking at facts, like the 19th Century history of Federal land disposal in the U.S. This is documented at length in many works like those of Professor Paul Gates, Cornell University historian. The lag between sale and beneficial use of land was often measured in decades.

3. A government selling land, even at fire-sale prices, would be swamped with cash flow. Humans being what

they are, these flows would be regarded as current income, and dissipated accordingly. Again, consider the use of national land sales in the U.S. in the 19th Century. They were used in lieu of current tax revenues, to meet the operating expenses of government.

4. Governments need revenues in perpetuity. If they abandon land as a source of continuing revenue they must resort to other sources, typically taxes on sales and consumption (like those that helped trigger the deposition of Czar Nicholas II in the first place). Most taxes on tax-bases other than land are of the nature that "shoot anything that moves," with the familiar effects of depressing production, misallocating resources, promoting underground and criminal economies, and lowering capital formation.

5. Private wealth being scarce in most Soviet republics, wealthy aliens would prevail in bidding for much of the best land. It is doubtful that any nation can long keep its sovereignty, or meaningfully represent its own median citizens, when most of its real estate is foreign-owned. In pre-commercial times one could own land in most countries only by swearing personal fealty to the sovereign from and under whom the land was held: that's why it's called "real" (from "regal") estate. Kings knew the link between land and power. Alien ownership was common only in conquered lands: it was the means of dominating, controlling and exploiting their people.

Sovereignty supposedly remains with the resident voters, but only the deaf and blind are unaware that money and property swing elections, and the state and the law acknowledge and -- some would say exist to -- uphold the superior rights of property. In 1978 a watershed constitutional change, "Proposition 13," was made in California. Although much California property is owned outside California and the United States, the successful campaign for Proposition 13 was propelled by the slogan "Property should only pay for services to property, not to people." That is a current version of the old contract theory of the state, whereby government is basically an agency contracting to serve landowners.

Some believe that taxes on retail sales promote saving and hence capital formation. This overlooks wealth effects, and is dismissed below under the discussion of "functional reasons" for taxing land rents.

Foreign ownership invites foreign invasion of sovereignty. Witness the foreign extension of the American "trading-with-the-enemy" act, applied to U.S. corporations holding property in other nations. Witness the long-term effects of Zionist land acquisition in Palestine. Witness the Canadian law, only recently repealed in British Columbia, whereby real estate as such had so many votes, based on valuation. Witness the property basis of voting that prevails in most public water districts in California. Witness the long history of gunboat diplomacy, and latter-day CIA manipulations like the replacement of Mohammed Mossadegh by the Shah of Iran. History shrieks: buying land is not just another commercial transaction, as the abstract theorists would have it. Landownership is political power.

6. The land market works better, on an ongoing basis, if land remains subject to regular taxes or other charges in perpetuity. Regular taxes, firmly anticipated long into the future, hold down present market prices by the amount of the capitalized taxes. This is a specific, visible instance of what it is now the fashion to call the "Ricardian Equivalence Theorem."

What avails the trade-off, to buy land cheaper, only to pay more over time? Median buyers are much better able to pay over time than up front. The effect is the same as financing all buyers, and so doing without credit discrimination as to rate of interest or other terms of lending. It removes all forms of credit rationing as factors in the land market, at the same time that it automatically meets the new buyer's greatest credit need, financing for the purchase of land. It yields all those benefits not just once, but for every succeeding generation of buyers in perpetuity.

The notable exception to this rule is the "Wright Act Irrigation District," discussed <u>infra</u>.

The writer does not endorse most current usages of the Ricardian Equivalence Theorem. It presumes most wealth owners are fully aware of all public debts, and foresee the future tax implications thereof. The verifiable fact is, most taxpayers are only aware of debts indirectly, via their current taxes; and only taxes on land are clearly capitalized into lower values.

The point is developed in Mason Gaffney, 1969, "Economic Aspects of Water Resource Policy," AJES 28(2):131-44 at p.133. See Appendix to this chapter. (Nic: I enclose relevant pages, am happy to accept your decision whether to include.)

The same force that helps the median buyer, conversely, inhibits the "strong-handed" speculative buyer who esteems land more as a store of value than as a factor of production, who grasps simply to be grasping, or to place surplus funds where they will keep with minimal care. A land tax stings the sleeping owner who clings to lands from inertia and lassitude, and bids him or her release them to youth and enterprise. It legitimizes and supports property only as a means to produce wealth, not property for the sake of property. It penalizes pure possessiveness. It overpowers the ancient vice of self-justifying acquisition, the auri sacra fames of Virgil, the "proputty, proputty, proputty" lampooned so mordantly by Alfred, Lord Tennyson, the Absentee Ownership savaged in Thorstein Veblen's final testament, the landlordism searchingly psychoanalyzed by Leo Tolstoy and Russian populist novelists of the 19th Century.

7. Counterproductive rent-seeking behavior, in the most primal sense, is maximized when land is simply privatized without the state's reserving substantial servitudes, especially tax power. Private rent-seeking, the prime cause of legislative corruption and logrolling, would then dominate the planning, timing, sizing and location of infrastructure of all kinds.

8. Local governments, traditionally undernourished and weak in much of the Soviet Union, also need revenues in perpetuity. It is possible that strengthening local governments to provide local micro-infrastructure would fill nearly as great an unmet need as the development of a private sector itself. Local government only thrives with its own proper revenues.

9. A means is needed gently to pry loose surplus land from state agencies like ministries in charge of production. Forcing sale of surplus lands would be drastic and unlikely to be broadly implemented, for the same reasons the death penalty is not widely used. It would be reserved for extreme, flagrant cases after long review, appeals and delay. The alternative of ongoing land taxation, without exempting state agencies, is more workable in practice. Taiwan affords a precedent.

"Northern Farmer, New Style"

W.S. King, "Land Value Taxation in Taiwan: Present Status," in Isaac

The Soviet republics may regard lands as common, but not as "commons" in the sense of open range. They are not starting from that kind of clean slate. Land is tenured. It is controlled by existing agencies that are just as possessive and righteous as the U.S. Forest Service and the University of California (54,000 acres and more, all used "for educational purposes"). These agencies have important core functions. The #1 priority in privatization is to induce them to identify and sell their surplus lands, while retaining and better using their essential lands (the University, for example, might focus more on research and teaching, rather than land speculation).

10. Public acquisition of lands for such uses as rights-of-way (r.o.w.), schools, reservoirs, air bases, parks, and watershed protection becomes much more costly when all land is privatized first.

What about selling movable property, like inventory and machinery, owned by state enterprises? Here the objections to selling for a single up-front payment are far lighter. The mean residual economic life of modern industrial capital is only a few years, and the selling price is a correspondingly low multiple of cash flow. Thus, purchases are self-liquidating in a few years or, with many inventories, just a few months. Financing purchase is, accordingly, much easier for borrowers, and requires much less money, than financing land, whose price is a high multiple of cash flow.

Buyers of durable structures affixed to land generally want financing; we do not belittle the need. We do stress, however, that financing structures is easier when buyers need not also finance the land under them. There are, in fact, many instances of sellers' broadening their markets by selling houses separately from the land.

Ofori (ed.), Real Property and Land as Tax Base for Development, 1991 (scheduled), Taoyuan, Taiwan: Land Reform Training Institute.

The multiple is high because the future life of land is infinite, and its cash flow (rent) is even likely to rise over time.