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Academic Strictures: a Critique*

Few economic theories are as simple, as symmetrical and as sound as the one advocated as a fiscal policy by Henry George in *Progress and Poverty*. A university philosopher has described it as 'a thing of such elegant simplicity as to be intellectually beautiful'.[1] Yet contemporary academics, with a century of scholarship upon which to draw, still succeed in distorting the remedies promoted by George. Until the learned people are able to get their facts straight, we can hardly expect the policy-makers to adopt a radical approach to the problems arising from the ownership of property and the distribution of income.

There is widespread misrepresentation of the theory, and it is a matter for regret that we have to review these rather than immediately elaborating how a 100% *ad valorem* tax on land values would dramatically alter the dynamic mechanisms of the industrial economy in the capitalist West and, by inference, solve (or drastically ameliorate) many psycho-social problems that have economic origins.

On the whole, Henry George is dealt with in dismissive terms by authorities of disciplines such as economic theory and urban studies. Four criteria were employed in the otherwise random selection of examples that are examined here. First, George's critics were selected for the means that they afford us to explore vital aspects of his theory. Second, the writers are teachers in higher education. Third, a geographical spread was considered useful, given that the problems dealt with are universal, and require global action. And fourth, authors were selected in order to obtain a spread of views right across the political spectrum.

Murray Rothbard's *For a New Liberty: The Libertarian Manifesto*, has become the 'bible' for the new Libertarian Party in the United States.

* This chapter is a review of academic misrepresentation of Henry George's thesis, which may be safely passed over by readers who prefer a less abstract exposition of the subject.

Rothbard justifies the exclusive proprietorial rights in land on the basis of the homesteading model. Provided no traceable person is wrongfully deprived of a piece of land to which he had prior legal claim, then one could assert the right to ownership of the land without impediment from the state.

Our interest is not so much in Rothbard's own theory of property (the internal contradiction, of course, is that the liberty to own beneficial interests in land is not generalised for the benefit of all, without exception), as of the impression that he creates of Henry George's alternative. Rothbard suggests that George wished to carve up the land surface of the globe in equal portions:

> ... it is obviously impossible for every person in the world to exercise effective ownership of his four-billionth portion (if the world population is, say, four billion) of every piece of the world's land surface. In practice, of course, a small oligarchy would do the controlling and owning, and not the world as a whole.[2]

The issue about who would control the land under the Georgist system is dealt with below. The main point here is to note that George did *not* advocate the physical reapportionment of land, on an equal basis or otherwise, among the world's population. His concern, through the fiscal system, was to reallocate the *value* of natural resources through the national exchequer.

But according to Graham Hallett, a senior lecturer in economics at University College, Cardiff, the introduction of Henry George's tax would destroy the value of land: *ergo*, there would be nothing to reallocate through the exchequer. Dr. Hallett states that the tax, 'by eliminating all net rent, was designed to reduce the value of land to zero'.[3] This is an astonishing conclusion for an economist to draw. If the whole of the annual value (i.e. economic rent) were transferred from the private to the public sector, through the tax system, then the *selling price* of land would certainly be reduced to zero; but the rental value would be unaffected, except insofar as the tax would destroy that portion that constituted the speculative element of asking prices.

Dr. Hallett, however, is not finished with his interpretation of George's words:

> If all profits from land use are eliminated, there is no incentive for any change in land use to take place. In other words, the price system would be eliminated as a means of allocating land between competing uses, and it would be necessary for all development and allocation to be undertaken on a purely administrative basis by the State. This, ironically, was quite contrary to Henry George's ideals; he somehow thought that his land tax would permit a system of unrestrained private enterprise, and this confusion has continued down to the present.[4]

The confusion, however, rests with Hallett. The price system — in this case, the market-determined rental levels — *would* continue to determine allocation. Land users would continue to possess the land so long as their economic returns were such as to enable them to compete with others for the retention of the right to possession. In other words, so long as they could afford to pay the annual land tax (= economic rent, which is what tenants in town and country pay to landlords prior to the introduction of land value taxation), they can continue to keep the land in its present use. When, however, through the growth of productivity and know-how, better uses for the land emerge which push up its value, *then* existing users are obliged to compete by adapting the use to which they put the land — or relinquish their possessory titles in favour of others. By better use, we mean those uses which would yield a higher income for everyone, including the community through the fiscal system.

A cornerstone of Henry George's system was the requirement that man, in order to remain free, needed to distance himself from a socio-economic model which necessitated bureaucratic controls. The socialist model was anathema to George, and he proposed a modification of the existing capitalist system because this would enable men to retain the service of the free market system. But this does not mean that his alternative socio-economic framework could not accommodate a certain amount of land use planning.

In recent decades, the planners in the city halls of the world's great urban connurbations have come to recognise the importance of efficient land use. Their solution has been a proliferation of plans, in which geographical zones are designated for different uses. These plans are negative, telling people what they may not do rather than encouraging them to do something better with the land. But our immediate concern is not with the value of such negative plans: they can be taken as a datum, in the same way that land speculators take them as given. The point, however, is that land value taxation, if it is to make a major contribution to the living environment, must be capable of making a positive contribution to urban society. It is with interest, then, that we can turn to the views of Leonie Sandercock. In addition to being a teacher of urban studies, in Melbourne, she comes from the Australian continent which has a long tradition of municipal taxation of unimproved site values. We would therefore expect her to have a sound appreciation of Henry George's prescriptions.

In *The Land Racket*, Sandercock claims that Henry George proposed the taxation of land 'at different rates according to the different uses to which it was being put'.[5] This is an elementary error, but urban economists do not seem too anxious to pay due regard to the facts so far as Henry George's solutions are concerned.[6] In fact, George proposed a uniform *rate*: namely, a 100% tax on the current market rental value of all land, whatever its present use. George knew that a variable rate would distort the pattern of land use.

Owners would be encouraged — against the market trends, which are simply collective signals of the people's preferences — to re-schedule the use of their land to achieve the lowest tax liability, rather than the optimum current use.

Sandercock dismissed George's solution as 'much-too-neat' and utopian.

> It bears little relevance to the nature of today's land issue, which has less to do with whether it is being productively used and more to do with its unequal distribution and with the inequalities that that distribution then produces, particularly in large cities.[7]

The existence of vast tracts of vacant land in the hearts of our cities surely warrants appropriate recognition from a land economist? That such a vital issue can be glibly dismissed tells us a great deal about the shortcomings in present knowledge about the social and economic costs of vacant urban land, which no-one has satisfactorily quantified.

But let us turn to the issue that Sandercock considers to be most important. She takes the view that the distribution of land is the major cause of our problems — hence her proposal for partial nationalisation.[8] If the whole of the economic value of land (rather than the land itself) is appropriated from the current possessors, does this not solve the unequal distribution? A full land tax reallocates the economic surplus but it safeguards against the fragmentation of holdings. Is this not eminently practical rather than utopian?

We now move to a class of criticisms of the proposal to tax land values which are practical. The most important of these is that a pure land value tax could not be implemented because of the difficulty of isolating economic rent.

Prof. Richard Lipsey, in his best-selling textbook on economics, correctly notes that a tax on economic rent cannot be passed on to consumers: it falls exclusively on landowners.[9] But he then claims that identifying economic rent is 'At best...difficult, at worst, it is impossible'. Most of the rental income of a modern economy derives from the urban sector, where, as Lipsey notes, 'The high payments... are largely economic rents'.[10] The value of city land arises exclusively from locational advantages. If, then, we can accurately value this land, the tax authorities could capture the full unearned rental income.

We can rebut the suggestion that such an exercise in valuation is difficult by pointing out that the highly-qualified profession of valuers and surveyors have built their skills on a tradition which can be traced back to classical antiquity.[11] Alternatively, we can point to Denmark, which since it passed the Land-Value Tax Act (1922) has employed modern methods to value land apart from buildings and has levied a higher rate on the former than the latter. The value of urban and rural land is published on maps, which are available for taxpayers to scrutinise and challenge if they think that the valuers have erred in their judgments. A minute proportion of the valuations become the subject of litigation.

Denmark uses capital values rather than annual income for the purpose of valuation. This basis has been defended by K. J. Kristensen, a former chief of the Valuation Department of the Directorate of Assessments, Denmark, in the following terms.

> Since tenancy is exceptional it was not thought advisable to assess the annual value. Annual value will, perhaps, be found the better basis in countries where the landlord-and-tenant system is prevalent and possibly also when we approach the point at which the greater part of economic rent is taken in taxation for public purposes.[12]

Professional valuers, acting on behalf of both private landowners and taxation authorities, perform valuation exercises as a matter of daily routine, but this is not a very interesting objection to the Lipsey criticism. More illuminating, for discerning the directional influences of land value taxation, is our contention that *without* the ability to value land, property owners would not be able to decide when to pull down a building that had lost its value in relation to the value of the land on which it stood. If economic rent was, in practical terms, elusive, this would be a serious constraint on the ability of the free market to renew the structures in our cities. This critical problem can be evaluated by reviewing evidence from both the private and public sectors, in the process of which we will see that accurate assessments of economic rent are constantly being made by those who perceive a gain in doing so.

During the boom of the early 1970s, 'asset-stripping' became a vogue activity among land speculators. They were able to calculate that many industrial and commercial companies were failing to reap a rate of return consistent with their capital investments *if the true value of their proprietorial rights in land were taken into account.* These companies were ripe for take-over bids. As soon as the companies were bought, the strippers redeveloped the properties in order to realise the full value of the land. Clearly, these operators were able to value the land apart from the buildings that stood upon them. But in case it should be thought that speculators have access to methods that are denied to taxation authorities, we can review the case of Johannesburg.

In 1919 the city fathers of this, the largest South African city, introduced site value rating (the local property tax). Since that date, not a penny has been raised on the value of capital improvements on the land. In the postwar years, a succession of official and commercial inquiries (including two by the Chamber of Commerce in 1948 and 1953) evaluated site value rating, and endorsed its continuation. This is not surprising. It meant that entrepreneurs were not deterred by the tax system from constantly up-grading the capital investments on which they depended for productive success — by re-investment in new buildings or renovating aging structures. This is the theory: what are the facts?

In 1973 John McCulloch, the City Valuer of Johannesburg, was assigned the task of raising the valuation roll of 140,000 properties — a larger number of parcels than in Boston, Massachusetts — to something close to market values. He reports that the up-dated valuations were within 5% of market values.[13] Objections resulted in only 42 slight reductions 'as a result of factors such as unregistered servitudes and nuisance problems'.[14] Land in Johannesburg is valued 'as though vacant', and that value should represent the market value in terms of actual rights *or potential* irrespective of what is on the site at the time of valuation.

As a result of site value rating, states McCulloch, 'The development of Johannesburg has been continual, despite minor economic slumps, whereas in other cities where improvements are taxed, development has been sporadic in terms of minor economic booms and slumps'.[15] What were the problems associated with the process of valuation?

> Land value estimation is no great problem using the residual technique and vacant land sales. Fortunately, many central-city properties are bought for the land only, and the buildings, though in many cases very substantial are demolished. This category of sale is treated as a vacant land sale or as a demolition sale, and the courts have accepted this demolition sale category as depicting vacant land value.[16]

Because of the incentive to continually improve the capital investments, a global survey of office rents in 1980 revealed that, while London topped the league table at £20 a square foot, the cheapest city was Johannesburg at a mere £3.85.[17] Despite the low rents, entrepreneurs found it profitable to invest in buildings at a faster rate than comparable modern cities. The consequences for economic prosperity — the ease with which people could start new enterprises — are self-evident.

Finally, moving to North America, we can consider the graded property tax employed by Pittsburgh, Pennsylvania, where land and buildings are assessed separately. As 1979 drew to a close, the city needed an additional $23.2m. in taxes to balance its budget. The city council wanted to raise the whole amount by further raising the tax on land, which was already higher than the tax on buildings. They voted 8-1 to increase the tax on land by 48 mills,[18] and to increase the wage tax by only 0.25%. This meant that 80% of the tax increase was placed upon land, almost doubling the tax on land to 97.5 mills (while leaving the tax on buildings at 24.75 mills). The average cost to homeowners was an additional $84 a year, compared with $225 for average wage earners if the income tax had raised the same revenue. One reason for these savings was that the land tax fell heavily on absentee owners who owned much of the city's prime property.

Pittsburgh had taxed land at twice the rate of improvements since 1925. When, in 1979, the city taxed land at nearly four times the rate on buildings, some critics predicted a negative effect on construction. A preliminary study of trends in the first 12 months after the marked increase in the land tax revealed a rise in the rate at which people were willing to improve their homes, and an increase in the sale of vacant sites.[19] These trends were in the direction predicted by the theory. The local citizens were evidently satisfied, for a year later (1980) they raised the land tax to 125 mills.

How much more satisfied those citizens would be if the full burden of the property tax fell exclusively on land values. Prof. Mason Gaffney, a leading expert on the US property tax, reported that 20% or more of Milwaukee would be rebuilt immediately in the absence of a tax on buildings.[20] He arrived at this conclusion by taking into account the rise in land values compared with the combined values of land and old buildings. The implications for the regeneration of derelict inner cities are enormous. At present, governments are spending billions of dollars which are levied out of earned incomes to subsidise the rehabilitation of the physical environment of the great urban centres. Yet all they need do is switch the tax emphasis to impose a cost on those who choose to under-use the land that they monopolise: private capital would then respond by voluntarily replacing worn-out structures with new buildings at no cost to the payer of income taxes.

This fiscal strategy was promoted by a sub-committee of the US House of Representatives' Committee on Banking, Finance and Urban Affiars, which noted:

> Real estate taxes in most US jurisdictions favour speculative land holders over builders or land users. In Alabama the drastically low property tax (effective rates below 1%) contributes to (1) large land holdings, so that only five corporations own over half the undeveloped land in Jefferson County surrounding Birmingham; (2) absentee ownership; and (3) under-development — the nation's largest iron ore reserves are lying fallow and iron workers are laid off.[21]

The perverse and discriminatory effects of US tax policy can be illustrated by reference to commercial and industrial properties. These are assessed at rates 32% higher than the vacant land held by speculators.[22] It comes as no surprise to learn that 22% of all privately-owned land was vacant in central cities with a population of over 100,000 in 1968.[23] This was matched in the 1970s by a figure of 24% of land held vacant on the fringe of American cities.[24]

We have now seen that the empirical evidence proves that land value taxation is administratively feasible. Critics who oppose the policy would do better to argue that speculation has not been abolished from cities like Johannesburg or Pittsburgh, where there is a measure of fiscal discrimination against income from land. Given the force of this point, we need to address ourselves to the defects in the property tax, which explain the shortfall in results and point the policy-maker in the direction of the appropriate reforms.

The first issue concerns the way in which the present law relating to the assessment of values is observed. One leading US tax authority, Prof. Dick Netzer, has noted that great advances would be made in the operations of the land market if the professionals did 'what the laws say should be done; assessors have long antedated the White House staff in presuming that laws need not be obeyed'.[25]

US federal and state governments lose billions of dollars through under-assessment of land values. The facts are known to the politicians, yet inertia —and corruption—has operated in favour of the speculator.

> To their discredit, some state legislatures deal with illegal assessments and related irregularities, not by correcting them but by legalizing them. Powerful landed interests in Alabama frustrated court-ordered assessment improvements throughout the 1970s, ex-Mayor Vann asserts, by creating 'a jumble of computation that no one can yet untangle'.[26]

But even when the authorities record accurate assessments, the level of tax rates are too low to neutralise the malign effects of the 18-year cycle in land values. The impact may be somewhat reduced, but not banished. For example, in 1973 Johannesburg's city valuer, John McCulloch, paid a tax bill of 0.56% of the market value of the land underneath the house in which he lived. This was less than the amount that he paid for water and electricity, the removal of rubbish and sewerage services. This rate is not designed to exploit the revenue-raising potential of the land tax, let alone expect it to yield additional dynamic benefits like thwarting speculators.

We can conclude that the evidence suggests that only a full recovery of all the economic rent will eliminate the incentive to speculate. This conclusion on a free market solution is offered, here, as provisional: we have yet to explore all the evidence. But what now appears to be beyond dispute is that existing treatments of Henry George's thesis have to be treated with considerable caution. If the socialist models for coping with the land market are inadequate, then the capitalist system will have to begin a fresh reappraisal of the free market options; and that means that the policy-makers will not find much of the existing literature on land value taxation helpful in their reassessment of how the land market ought to operate.

Notes

1 H. Steiner, 'Liberty and Equality', mimeo., University of Manchester, April 1980, p.14.
2 M.N. Rothbard, *For a New Liberty: The Libertarian Manifesto*, New York: Collier, revised edn., 1978, p.34. For a full critique of Rothbard's previous writings on Henry George, see C. Lowell Harris, 'Rothbard's Anarcho Capitalist Critique', in R. V. Andelson, *op. cit.*
3 G. Hallett, *Housing & Land Policies in West Germany & Britain*, London: Macmillan, 1977, p.112.
4 *Ibid.*, p.113.
5 L. Sandercock, *The Land Racket*, Australian Assn. of Socialist Studies, 1979, p.79.
6 For example, P.N. Balchin and J.L. Kieve, in *Urban Land Economics* [London: Macmillan, 1977, p.124], claim that George 'proposed a 100% tax on *increased rents*'. John Stuart Mill had certainly proposed that unearned *increments* over and above existing rental levels should be appropriated, but Henry George advocated that the whole of current rental income should be redistributed for the benefit of everyone.
7 *Op. cit.*, p.79.
8 *Ibid.*, p.95.
9 R. Lipsey, *Positive Economics*, London: Weidenfeld & Nicolson, 5th edn., 1980, p.370.
10 *Ibid.*, p.369.
11 O. A. W. Dilke, *The Roman Land Surveyors*, Newton Abbott: David & Charles, 1971.
12 K. J. Kristensen, 'Land Valuation and Land-Value Taxation in Denmark', paper presented to the Eleventh International Conference on Land Value Taxation and Free Trade, New York, Aug. 30 - Sept. 5, 1964.
13 J. McCulloch, 'Site Value Rating in Johannesburg, South Africa', in R. W. Bahl, editor: *The Taxation of Urban Property in Less Developed Countries*, Wisconsin: University of Wisconsin Press, 1979.
14 *Ibid.*, p.264.
15 *Ibid.*, p.267.
16 *Ibid.*, p.265. Seventy-nine South African towns raised their property taxes from site values alone in 1982. In New Zealand in 1981, assessments of unimproved land values were the basis for the property tax levied by 189 county, district and town authorities (81% of the total).
17 'World Rental Levels', London: Richard Ellis, January 1980.
18 One mill is $1 tax per $1,000 of assessed value, equal to 0.1%.
19 Report by the Center for Local Tax Research, New York, 'Pittsburgh tax shift yields promising trends', *Land & Liberty*, Sept.-Oct. 1980.
20 *Compact Cities: A Neglected Way of Conserving Energy*, Joint Hearings before the Sub-Committee of the City and the Sub-Committee on Oversight and Investigations, Ninety-Sixth Congress, First Session, Dec. 11 and 12, 1979, Washington, DC: US Govt. Printing Office, 1980, p.241. See also M.M. Gaffney, 'Property Taxes and the Frequency of Urban Renewal', Harrisburg, Penn.: National Tax Association, n.d., paper presented to the 57th National Tax Conference, Pittsburgh, Penn., Sept. 14-17, 1964.

21 *Compact Cities: Energy Saving Strategies for the Eighties*, Washington, DC: US Govt. Printing Office, 1980, p. 61.
22 *Ibid.*, p. 64.
23 A. D. Manvel, 'Land Use in 106 Large Cities', in *Three Land Research Studies, op. cit.*, p. 20, Table 1. This result was confirmed by a study of 86 cities in 1971. R. M. Northam, 'Vacant Urban Land in the American City', *Land Economics*, Vol. 47, 1971.
24 Brown *et al.*, 'Land Ownership . . .' *op. cit.*, Table 18.
25 D. Netzer, 'The incidence of the property tax revisited', *National Tax Journal*, Vol. 26, 1973, p. 535.
26 *Compact Cities, op. cit.*, p. 65.