

FROM "Prague Spring" to "Romanian winter", the spirit of freedom remained alive behind the Iron Curtain despite the brutality of the secret police. And in the space of a few months last year, that spirit emerged in the glow of a thousand candles in the squares of Budapest and Bucharest and the communists capitulated without a fight. Only the tyrant Ceausescu sent in his killers, to no avail.

Life in the former satellite countries of Eastern Europe can now only improve. But are they compromising their prospects, by fleeing into the hands of western financiers? The IMF, in extending loans to Poland and Hungary, is insisting on turning these countries into carbon copies of the western model. The market system has proved its superiority over what Mikhail Gorbachev calls the "Administrative-command" method of regulating production - an approach which he blames on Stalin.

Gorbachev still maintains that the USSR will remain a socialist society in the image of V.I. Lenin. We are sceptical: *perestroika* is made up of concepts such as democracy and the market mechanism which, if they were to find institutional expression, would destroy socialism. Much now depends on how these countries develop their tax policies. These are inextricably linked with the transitional programme of freeing prices by removing subsidies.

Privatisation is also a key ingredient in the new strategy. Western advisers flying in to Warsaw are advocating across-the-board sale of the means of production. That is a fundamental error of historic proportions. A

Irony after Marx



• Gorbachev

more sophisticated appreciation of property rights and the way the free market works would enhance the prospects of a peaceful transition from socialism. Gorbachev, addressing his party's central committee in March last year, realised that the cutting edge of this debate was the tax system:

We must enter the next five-year period, having a smoothly operating mechanism of financial relations between enterprises and the state budget. In this connection there is a need to speed up the working out of scientifically substantiated rates of income tax and rental payments to go to the budget. It is of paramount importance to establish a procedure for replenishing the local Soviets' budgets.

A scientific examination of these issues would lead Gorbachev to scrap all ideas of an income tax. Instead, he would fund the Soviet Union with a tax - at the rate of 100% - on the rental value of land and natural resources. This "tax", of course, would actually be a user fee. Natural resources already belong to the state. All the benefits of individual enterprise would be secured by the use of leases granted on payment of rents, the levels of which must be determined by supply and demand - the market.

It is ironic that the first Single Tax society - the vision of Henry George, the American Social Reformer and powerful advocate of individual freedom and the free market - could emerge from the entrails of Marxism

Don't look West

LECH Walesa returned to Warsaw in December after touring the US and UK to argue for western assistance for Poland

The Solidarity leader did not carry a begging bowl; what he wanted, he told Prime Minister Margaret Thatcher, was more British firms to enter into joint ventures with Polish firms. A derisory 10 or 15 companies were exploiting the economic possibilities, compared with 380 West German firms.

Time is fast running out for *perestroika*, but the worst is yet to come. The restructuring of the command economy will generate hardships before the shops begin to fill with the food and consumer goods that everybody

INSITE reviews the future for the East European countries that are abandoning the command economy - and are appealing to the West for help

east of the crumbling Berlin Wall wants. And Mr Walesa places some of the res-

ponsibility for the future on the West.

"If by March we don't get Poland, Czechoslovakia and Hungary on the road to reform, then the West will have problems with integration on the scale of, I don't know, millions," he warned one western correspondent.

"Help us get reformed one after the other, and you will be able to live in peace. We want to keep all Poles, Germans, Czechs, Romanians in the places

Continued on Page 4 ►



• Troubled past: Russian tanks subdue Prague in 1968

← From Page 3

where they live. If not, we are losing as a nation and you're losing because you can't absorb it all."

But far from being a time for fear, the prospects offer historically unique opportunities. And ironically, the reformers of post-communist society ought not to be looking westward for the answers: they already hold in their hands the single most powerful weapon for successful change.

THE mere identification of the problems confronting President Gorbachev is sufficient to throw up the correct answers. These focus on the need to create a new system of pricing, remove the subsidies that distort the alloca-

CORRECTION

IN THE Sept-Oct. 1989 issue we stated, in a report from Washington, that unemployment during the 1980s reached a peak of 30bn people in the OECD countries. The figure should have been 30m.

tion of resources, and redeploy workers from inefficient state-controlled firms.

None of this can be accomplished without first articulating the appropriate fiscal system, one that will facilitate the goals of *perestroika*. And we find that at the heart of the debate ought to be the concept of land-value taxation.

• The USSR will have to establish a new system for raising government revenue consistent with the objective of a market economy. This provides the opportunity to create the first rational tax structure in the world.

The lessons that can be learnt from the West are those of fiscal failure or inefficiency. Capitalist societies extract exchequer revenues from earned income, consumption and profits on the basis of a tax system that constitutes a built-in contradiction to the economy, a direct obstacle to the process of growth and prosperity!

According to all economists, the only frictionless fiscal policy is the
This failure stems from a con-

ceptual error that can only be remedied once **market-determined rents** have been imputed to natural resources. But even if an efficient market in land and natural resources were created, the best results would not be achieved if a major part of rental income were privately appropriated; for this would permit the land market, under the influence of people seeking to pocket part of the socially-created rent of land, to generate frictions that would prevent the optimum level of economic growth.

tax on the rental value of natural resources.

• **Economic growth.** Between 1985 and 1988, the major brake on the Soviet economy has been the failure to improve on the efficiency with which natural resources were used (Aganbegyan 1989: 243-44).

This failure has seriously distorted investment and production in the urban/industrial sector, slowed the pace of change and retarded the standard of living. As Abel Aganbegyan, one of Gorbachev's expert advisers, notes of the last three years of Soviet "reform":

The gross imbalance in favour of our raw material production is a burden to the whole structure of our national economy, retarding it and preventing its development.

• **Prices.** Other taxes are treated as costs of production; they are incorporated into product prices and passed on to consumers. This raises the general level of prices in the economy. For the USSR, this would be a disastrous turn of events as it is now confronted with the urgent need to cut subsidies.

Put another way, it has to raise prices so that they accurately reflect the costs of production. It would not be rational to aggravate this vital transitional

Community package to benefit everyone

A HIGH tax will do one thing, reduce the quantity of that thing – with one exception, a high tax on land. Land in its natural state, especially as space, has not come into existence because someone paid to get it produced. Yet we pay a very high price for the use of some land. When we do so, the payment does not go to someone for creating the land.

Perhaps the person who gets the payment, and certainly prior owners through history, will have invested money and effort in making the parcel and the neighbourhood more desirable. Something of what present users pay will represent compensation for such investment. Most urban land, however, brings prices which are vastly greater than the worth of such inputs.

The amount paid will generally exceed whatever was needed to get the land (broadly defined) in its present state. What city today has more land because the average price which people must now pay is three or four times that of a generation ago? If more of the payments for land had been channelled into the local government treasury, the land as space would still be available. For the future is not such action sensible?

Price has an economic function other than getting things produced. That other function consists of guiding the use, of preventing waste in consumption, of allocating resources according to their relative productivities and scarcities. A "high" price for some land is essential for guiding it to the best available uses.

• The virtuous impact of land value taxation is explained by C. LOWELL HARRISS, Professor Emeritus of Economics at Columbia University, New York.



A good market in land, one oult around prices, is important for inducing the most productive use of this resource.

To assure efficient allocation of land, the user must pay; but the owner need not receive all that is paid. Therefore, government can take much of what the user pays, while keeping pressures and incentives for efficiency in use. But not take all.

Present owners have made outlays in good faith and ought not to be deprived of investment made in accordance with established rules, except as noted below. Moreover, an owner must feel confident that his effort in finding a use yielding more return will bring *him* benefit.

As private owners get less and the public treasury obtains more, the price system would still allocate land use. The effective supply of land would go up in the sense that more would be offered on the market. And the tax rate on buildings and machinery could be

kept much lower than perhaps otherwise – as in the United States, where much man-made capital is taxed more heavily than seems to me desirable.

Investment by owner (or tenant) – or by a land developer – in improving land ought to be treated as the input of capital. To the extent practicable, such inputs deserve the same tax consideration as investment in structures.

Over the longer run, landowners would get less of the increment in land values. The general public would get more. On this score, the equity results commend themselves. The community can capture in taxes some of the values which it has created – including values resulting from local government spending on streets, schools and other facilities. Localities can obtain funds to pay for local government by absorbing part of the values created by society.

Socially created values would go for government rather than private uses. The localities doing most to make themselves attractive would have most of this revenue.

As for the future, the tax on land value above present levels would be almost burdensomeless, except as owners of land and their heirs get less "unearned increment" from rising values. Where land values drop, the annual tax at the higher rate would decline.

The necessity of paying higher tax on land would put pressure on the owner to get the best income possible – "higher and better use."

process by adopting taxes that raise prices higher than is necessary for the sake of efficiency.

LVT is the one tax that falls on the surplus income (rent) and cannot be passed on to either the wages of labour or to the profits of capital; it is a tax that remains where it falls – on the annual rental value of land. The British

Treasury recently explained this process:

The effect of taxes depends upon the demand and supply elasticities of the commodity being taxed. For example if the supply is very elastic the main effect of a tax is to increase the market price; if the supply is very inelastic the main effect of the tax is to decrease the net of tax price. The supply of land, for

example, is relatively inelastic and the usual long term effect of property rates (taxes) is largely to reduce rents and land values (Treasury 1984: 9).

This economic fact of life ought to be borne in mind by Soviet reformers. The economic consequences can't be ducked; the failure of governments to

Continued on Page 13 ►

← From Page 5

Expenditure was to be reduced below receipts to the tune of 20m. *livres* per annum, in order that debts previously incurred might be paid off.

This absolute necessity was to override any protests by administrators responsible for spending, who were in future to make prior reference to the Controller-General.

The King himself, so he was tactfully informed, was to restrain his own liberality to hangers-on at Court, and to think instead of "the misery of those from whom exactions sometimes have to be made by the most rigorous processes...." Private profit from the collection of taxes was a source of corruption among the nobility, and was to be discouraged.

Thus far any prudent Controller-General might have gone; but Turgot the physiocrat went further. What he wanted, and probably above all else, was "a more equitable distribution of taxation, in order that the people may be appreciably relieved, without much diminution of the public revenue". In fact, he wanted the *impôt unique*, or single tax on land.

Then came the rub. Not only, he wrote finally, would the reform of an unjust system be bitterly resisted by those who profited from the injustice, but the King's own generosity, and that of the persons most dear to him (i.e. his wife and his brothers) might well attach them to a universal opposition.

This was putting it mildly. In the event, Marie Antoinette and the future Kings Louis XVIII and Charles X all unhesitatingly espoused the cause of privilege; and Turgot, though he won the struggle for internal free trade in corn, ran into more serious trouble with his attempt to make both nobility and clergy subject to taxation.

He never got round to concen-

take the impact of fiscal policy into account does not mean a neutral response in the market for land and natural resources or the consumer markets.

There is a reciprocal effect on the way that the private sector uses land and distributes income (Banks 1989: 149-53), and on the pricing structure for consumer goods and services, if alternative fiscal policies are adopted.

• **Labour redeployment.** The large-scale reallocation of employees is another unavoid-



• **Abanbegyan: Gorbachev adviser**

able prospect. The impact of this traumatic event could be minimised and even turned into a rewarding experience. But governments can aggravate the transition if they misalign fiscal policy. Here's how:

Taxes (other than those that fall on land and natural resources) tend to raise prices above (marginal) costs of production.

trating the revenue on the land tax at all. The King remained convinced of the rightness of Turgot's views, but, giving in to pressures that might in any case have proved to be irresistible, dismissed him. His term of office had lasted 20 months.

So France went down the slippery slope to bankruptcy, revolution and the most appalling series of wars the world had yet known. The problem that Turgot

This causes unemployment, because less can be bought by consumers than would be the case if Price = (Marginal) Cost of production.

The tax on land values is the only fiscal policy that does not distort the pricing structure of the firm or the economy; so it represents a positive incentive to growth and the rational deployment of resources at the lowest possible prices.

The outcome of the Soviet deliberations on fiscal policy will have far-reaching consequences for world trade. The Soviet Union now wants to integrate herself into the system of international trade, as President Gorbachev reminded President Bush during their foul-weather summit off the coast of Malta.

He already has the choice of the best single weapon for providing the USSR with an exported thrust to economic growth: a country that adopts land-value taxation acquires a major advantage in terms of price competitiveness.

BIBLIOGRAPHY

- Aganbegyan, Abel, (1989), *Moving the Mountain*, New York: Bantam.
Banks, Ron (1989), *Costing the Earth*, London: Shephard Walwyn/CIT.
Treasury (1984), *Investment Appraisal in the Public Sector: a Technical Guide for Government Departments*, London: HM Treasury

attempted to resolve still faces us today.

Though we now have the benefit of the more accurate economic analysis of Henry George, will there ever be another statesman of the integrity and general moral stature of Jacques Turgot to try to put it into practice by means of the taxation of the value of all land? Only the future will tell.