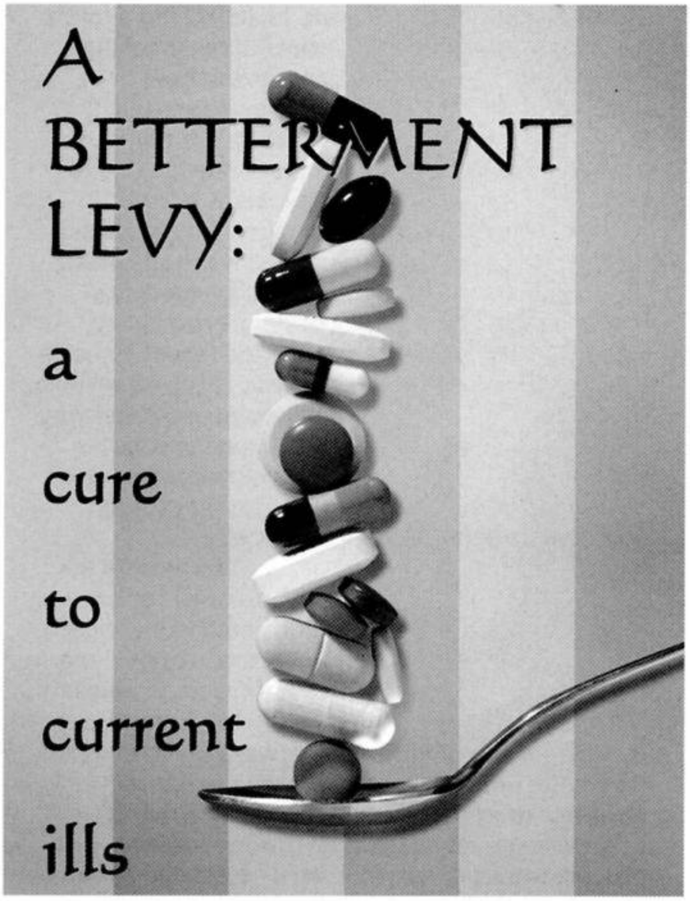
A BETTERMENT LEVY: a cure to current ills



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Exactly 100 years ago Winston Churchill and Lloyd George introduced a radical budget even by today's standards. The budget introduced a high land tax, while severely reduced all other taxes.

However, it was rejected by the House of Lords (or rather Landlords) for obvious reasons. I argue that a 100 per cent betterment levy with income, GST, capital gains, superannuation taxes, tariffs, dividends and corporate taxes, all abolished, or at least severely reduced, can simultaneously cure unemployment and budget deficits. This levy, sometimes called a "Mill tax" was formulated by John Stuart Mill, the great liberal philosopher of the 19th century.

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ARGUMENTS IN FAVOUR

A cure to a budget deficit

Prime Minister Rudd plans to spend billions on public infrastructure such as transport and school upgrades. Sounds great. However, the problem arises when one considers the "tax" system this takes place under. You build a school, land values in the area go up. The same is true for hospitals, roads, transport, shops or any other public good.

Question: why tax wages and not windfalls? Why should this value - created by government via our taxes - be crystallised in the parasitic hands of landlords and not recycled back into the Treasury's funds to build even more infrastructure that we use together? Why should the value of government windfalls and population growth be deposited to landlords when the owner of the land had no role in creating this value but we - the community - through our backbreaking labour and taxes - did? This is what JS Mill labeled as the "unearned increment". I call it a "betterment levy". It aims to reward hard work and savings, over speculation and idleness.

Only a betterment levy is able to make a profit out of government debt.

First, Hong Kong funds 35 per cent of its budget, which even now is in surplus, through land-based taxes while keeping all other taxes low. This encourages international business investment due to these tax incentives, raising revenues even further due to more capital inflows funneled into business investment not commercial property. Thus a betterment levy, with most other taxes reduced, in a competitive international tax system would make Australia an investment hub like Hong Kong, raising government revenue due to the influx of business investment while simultaneously employing locals.

Furthermore, this levy causes businesses to actually utilise their land and not withhold valuable sites from use for competitive or speculative advantage, like retailer giant Tesco. Rental sites are no longer withdrawn from the market due monopolistic influences but put into productive use. This levy allows government to recoup revenue by encouraging a more efficient use of land without penalising employment. With more people employed, there is less need for welfare expenditure.

Second, in the United States it costs $6 million and $10 million to build the Washington and Watergate bridges respectively. Valuators showed that the bridges lifted land values by $100 and $120 million in a 20km radius respectively. The bridge could pay for itself in one to two years. Government railroads increase value in a similar way. For example, UK property developer, Don Riley, calculated that lines cost the Treasury £3 billion to build, but lifted land values by £15 billion across a 1000 yard radius along the track one year after its creation. Infrastructure pays for itself!

Third, the city of Pittsburgh in Pennsylvania, USA, ranked America's "most liveable city". It uses a variant of a betterment levy, a land tax, to upgrade transport routes and to upgrade the aesthetic nature of the city. Here, too, their local council manages to run a budget surplus by recycling their "unearned increment".

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In America, researchers found a school with a good reputation could increase land values as much as $10,000. Similarly, British economists found increases as much as £25,000. Here, too, the school value can be recycled back into public coffers. Once again, the value of the school's reputation can be recycled back into the public purse.

This is called the "Henry George theorem", identified by Nobel Prize winning economist Joseph Stiglitz who showed that aggregate rents equal aggregate government expenditure. William Vickery quantified this assumption by showing transport and a betterment levy goes together: marginal rents mean marginal utility derived from access to transport utility. The above examples, however, imply aggregate rents can, in fact, equal more than government expenditure. You pay an "economic rent" based on where you are, not who or what you are; it is not about equality but equality of opportunity.

Clearly, with other taxes abolished, government can fund projects into the long term (the Sydney Harbour Bridge may reap windfalls of $40 million in the first year plus roughly the same next year … *ad infinitum*) and not waste our money via the ATO hunting "tax evaders" and a bureaucracy which needs 30,000 or more people to administer. Any surplus can be returned to the citizenry via a citizen's dividend.

Governments can run surpluses rain, hail or shine, like in Hong Kong and Pittsburgh.

A cure to unemployment

However, a betterment levy helps cure unemployment and poverty as well.

First, setting up a business should be simple and easy. Alas, high taxes and vacant commercial lots, due to exuberant rents are correlated with areas of high unemployment. How can a free market be free when people cannot access it? However, with business and personal taxes reduced or abolished, taxes would no longer eat into the profits of small business. There would be no business taxes and instead a tax on economic "rents" would be paid to the government. The landlord cannot pass over as they already charging the maximum rent the market can bear. Thus, vacant lots will be either utilised by landowners or sold to capitalists who value the site most and thereby employ people. With burdensome and perplexing taxes abolished, this would spawn employment opportunities and entrepreneurship, making it easier for people to set up business, increasing output without punitive taxes and artificially high rents which currently are a structural barrier to meaningful employment.

Consider Pittsburgh, PA. Before they had a betterment levy there were 4,000 vacant lots and unemployment of 9 per cent. After land tax there were only 200 vacant lots and unemployment is 4 per cent, and still dropping despite the world financial crisis. An extra 3,800 active commercial sites did miracles for local demand, firing up new businesses and employing thousands. Yet land prices only went up by 7 per cent in Pittsburgh. It was transformed from a high crime capital to an industrial giant.

Second, a betterment levy, contrary to popular belief, would be a farmer's best friend. Farmers pay just as much GST as a person in the city while living in a remote location. This is hardly equitable. With GST, income, business taxes on cars and machinery abolished, farmers in a remote location would pay barely anything (particularly on arid, submarginal land). But, where appropriate, government now has an incentive, in co-operation with local government, to build additional infrastructure due to these "windfalls". Such investment is also known to increase productivity and accessibility to the market place, which lifts land values once again but at a sustainable level justified by fundamentals.

it is not about equality but equality of opportunity

Third, any monopolies which withhold land from productive use, so as to knock out competitors from the market place, will be introduced to what capitalism is meant to be about - competition. It would simply become unprofitable in the long run to withhold land from productive use. It increases economic welfare as it increases competition.

It will not solve all social problems, but I do believe it can solve most problems.

Misleading counterarguments

Let me briefly dispel five counterarguments against a betterment levy.

1. "The 'unearned increment' cannot possibly be distinguished from the value created by the owner."

Wrong. We do it all the time ourselves. One, we have local rates and state taxes which are executed without much controversy. Second, we use valuators to give us a quote on our house, separating the value from the land. Third, the free market, even when doing housing insurance valuations distinguishes the property value from that of the land (i.e. the ground): the latter can never be taken away by a thief in the middle of the night or by any arsonist. This is not an issue.

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2. "This levy will decrease land values and destroy my wealth!"

First, the GST, payroll and income taxes are abolished; we would see increases wages and purchasing power simultaneously. Second, this is not a bad thing, if you believe in housing affordability for your grand children and removing the boom bust cycle. Locally, every eight years, and nationally every 18 years, land values plummet (like now) and in turn destabilise the banking system (like now). Land booms *precede* recessions - it is time this stopped.

Under the *status quo*, land inflation causes a surge in consumption via a wealth effect and investment motivated by capital gains. This stimulus to the economy evaporates once land values slump. We must instead generate genuine output. Money poured in land speculation could be better spent on *sustainable* investments like scientific research or business investment - real, disposable wealth.

A betterment levy, implemented over 10 years while other taxes are phased out, so as not to mess with company asset sheets, would eliminate speculative advances in land values. On the supply side, speculators must relinquish idle sites like the 1,000 empty homes in one small suburb of Melbourne, increasing supply. On the demand side, the capital incentive to buy land is eliminated, thus reducing prices. This will reduce household debt, casting thousands of families onto the brink of poverty and debt. Land is bought for today's use, not tomorrow's speculative gain. It is no wonder Pittsburgh has the lowest foreclosure rate in the US of any city or county.

3. "How will pensioners pay?"

They won't. Pensioners, at least for this generation, should pay NO taxes (or at least have a citizen's dividend given to them). PAYE schemes can occur over time or payments can be deferred if need be (in very rare instances), for those who are asset rich, income poor.

4. "This levy sounds like nationalisation of land, even socialism."

Actually, the *status quo* is socialism: millions of regulations, taxes on production and monopoly power due to owning land in the right location. Rent is an economic surplus, the result of economic activity by individuals. Taxing it has no deadweight loss (i.e. it does not distort output) and is created by *all* us (i.e. the community). Therefore, rents, not wages and profits, should be distributed between the state and the individual.

As Winston Churchill reminds us, incomes and speculation in shares, at least, are based on the *quid pro quo rule* (exchange like for like). Landlords evade this law of exchange when they reap windfall gains from the state. A labourer sells his work and gets paid (and taxed!) because he performs a service. A person invests in stock which allows the company to increase its capital base. A landlord, however, does nothing yet reaps the rewards of something he did not physically contribute to.

Government does not control the land whatsoever: it is up to the individual how they use it. The levy simply encourages the efficient use of land - a finite, natural resource. If used effectively, it can make the landlord wealthier without negative social excesses.

5. "Construction activity will be hurt."

It makes property development more profitable in the long run. In Pittsburgh construction, after a land tax was introduced was 68 per cent greater than pre-land tax due to asset price stability. Savings are funneled not *in*to land, but *on*to the land: more renovations and development of land occurs, employing labour. Alas, something tells me when land values plummet within our current boom-bust cycles, there won't be much "property development" going on. Clearly, stable land prices mean projects can be sustained over time, not just when the boom happens.

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Conclusion

Economists from the left (Keynes, Stiglitz) and to the right (Friedman, Hayek) all agree a betterment levy or a non-value added land tax is "the least bad" tax. Had Churchill's and George's reforms been implemented 100 years ago the world, today, would have been a better place. Now is Rudd's chance to set things right; to limit the fetish of land speculation and to make things both efficient and equitable for future generations. A betterment levy works if there is the political will to implement them. The problem, perhaps, with vested interest groups at stake is that a betterment levy is *too* good to be implemented entirely.