Designing a System of Compensation for the Introduction of Public Collection of the Rent of Land as the Principal Source of Public Revenue

Nicolaus Tideman

Introduction

Suppose that Britain were to abolish all taxes on productive activity and finance government entirely by collecting the rental value that land would have in an unimproved condition. No additional money would be paid for governmental activities; there would just be a change in the source of financing. The country as a whole would be richer, however, because people would now find it attractive to undertake productive activities that had previously been discouraged by taxes. Wages would rise, while labor costs to firms would fall, because the wedge of taxes would be removed. The return that individuals received from investing would rise, while the cost of capital to firms would fall, because the wedge of taxes would be removed. The record-keeping burden of taxation would be removed as well. Together these changes would make the economy tremendously more productive.

Why has such an improved public revenue system not already been implemented? Some people would say that there would not be enough revenue, or that it would not be possible to determine the rental value that land would have in an unimproved condition. If these were the principal concerns about public collection of rent, there would still be reason to do what can readily be done to assess land and collect as much public revenue as possible from land before turning to taxes that destroy economic incentives. Since these things are not done, it can be presumed that there are other reasons why more of the rent of land is not collected publicly. For this paper I assume that revenue will be sufficient and assessment will be feasible, in order to focus on another crucial issue.

I believe that, more than anything else, what keeps Britain from using public collection of rent as the principal source of public revenue is that some powerful persons and some weak persons would lose from the change. The selling price of unimproved land would fall to approximately zero. People who thought themselves wealthy because they possessed titles to land would find that that "wealth" had disappeared. But there would also be gains to everyone from the abolition of taxes. Those who would be net losers would be persons who had relatively large land holdings, compared to the amounts of capital they owned and their expected future wages and salaries. The extreme cases of persons whose losses would not be offset by gains would be landed aristocrats and retired persons with incomes derived from renting unimproved land. The losses of those in the first category would generally elicit little sympathy. However, by hiding behind examples of persons in the second category, those in the first category are able to deflate interest in the change. This paper addresses the question of how one would design a system of compensation for the introduction of public collection of the rent of land as the principal source of public revenue, so that deserving persons in the second category would be appropriately compensated, without burdening society with an undue obligation to compensate persons whose claims for compensation are inadequate.

II. Principles of Compensation

This section develops principles that might be used in the design of a system of compensation for a change in the public revenue system.[1] Any system of compensation requires principles. If the arguments that are made for these principles are regarded as unconvincing, then these principles can be replaced by some alternative set.

1. Neither Poor Widows with Nothing but Land, Nor Anyone Else, Should Starve.

The British Society, like almost all societies, recognizes its obligation to ensure that no one starves. Thus in evaluating claims for compensation, starvation is not the issue. No one is going to starve. The question is how the comforts of life are to be distributed among people.

2. By Using a System of Private Collection of the Rent of Land, a Society Incurs an Obligation to Those Who Rely on the Continuation of that System.

A person needs a place to live, so he buys a house. To buy the house, he must buy title to land under the house. Shortly thereafter the society in which the person lives realizes that the rent of land ought to be collected publicly, and the selling price of the land under the house falls to zero. There is a prima facie injustice in telling a person that if he wants a house he must buy title to land, and then telling him after he has bought the land that it has been decided that he must pay the rental value of the land to the public treasury. Some compensation or adjustment is needed.

3. Compensation Should Be Based on Net Losses Rather than Gross Losses.

Everyone will gain from the elimination of the VAT, the personal income tax and the corporation income tax. A person who gains as much from the elimination of these taxes as he loses from public collection of the rent of land does not have a respectable claim for compensation. Thus anyone who seeks compensation for losses from the introduction of public collection of the rent of land can reasonably be required to report his off-setting gains, and these can reasonably be set against the losses for which compensation is claimed.

4. Compensation Can Be Either a Lump Sum or a Series of Annual Payments.

It should not be necessary to mention the fact that compensation can be either a lump sum or a series of annual payments, except for the fact there is a tendency to think of compensation as a lump sum. Furthermore, there is an important advantage of making compensation a series of annual payments. The value of the benefits that people receive from removal of taxes on labor and capital emerge over time. By providing compensation as a series of annual payments, it is possible to adjust for the observed value of these benefits.

5. Past Gains from the Sale of Land Can Offset Claims for Compensation.

If a person has made money in the past through the sale of land at prices that were more than he paid for it, then these past gains can offset a claim for compensation for the introduction of public collection of rent. Some gains on land occur entirely without effort on the part of the person who gains, while others are the result of deliberate speculation. If there was no effort, then there is no moral basis by which the gainer can claim entitlement to the gain. It was an accident. If at a later time society realizes that all of the rent of land should be collected publicly, and this imposes a loss on the person, then, to the extent that the loss is undeserved, it is in the same category as the previous undeserved gain. Thus the gain offsets the loss, and it is only for the net loss that a reasonable claim for compensation can be made.

If the previous gain on the sale of land was the result of purposeful speculation, then the basis for using the gain to offset losses from the introduction of public collection of rent is somewhat different. Land speculators achieve their gains by being the ones who own land during a time when participants in the land market come to realize that the return that can be obtained from particular parcels of land is greater than had previously been believed. A reduction in land speculation does not lead to a reduction in total social product, but only in a change in who receives the gain. In fact, the discouragement of land speculation may be positively beneficial, since people who find land speculation attractive tend to be persons who have extreme views about how valuable it is to leave land idle rather than put it to current use. Since the discouragement of land speculation is neutral or beneficial to total social product, there is a basis for singling out the gains from land speculation for special treatment. They can be taken to finance compensation for those who lose from the introduction of public collection of the rent of land, without discouraging productive activity.

From the proposition that past gains on the sale of titles to land can be taken to finance compensation, it follows as a corollary that, if a person purchased title to land for a price that was less than its market value at the time when public collection of rent was instituted, then any claim by that person for compensation should be based on the purchase price and not on the value at the time when public collection of rent was instituted.

In any of these calculations involving purchases and sales in the past, it is important to adjust for inflation. This is accomplished by multiplying every purchase price and sale price by the ratio of the current price level to the price level at the time of the transaction, before the dollar amounts of different transactions are added, subtracted, or otherwise compared.

6. Those who Obtained Past Gains from the Sale of Land Titles Can be Required to Finance Compensation for Those Who Lose from the Initiation of Public Collection of Rent.

Principle 5 established that losses from the initiation of public collection of rent can be offset by past gains from the sale of titles to land. If a person obtained such gains in the past but does not have losses from the initiation of public collection of rent against which to offset them, then he can be called upon to provide compensation for those who do have such losses. The past gains were undeserved and can be regarded as the cause of current loses. If the land had been held rather than sold, no compensation would have been owed on the amount of the gain. Therefore it is reasonable to single out the recipients of such gains as persons who ought to finance compensation for those who lose from the initiation of public collection of rent.

7. Compensation Should be Limited to the Lifetimes of the Current Possessors.

One of the reasons that people may wish to own title to land is so that they can bequeath to their heirs the possibility of receiving an income without working. Public collection of the rent of land frustrates the possibility of achieving this goal by bequeathing land. But the heirs do not have a case for compensation. They do not have a right to a guarantee that that which is bequeathed to them will be valuable. For the loss of value of land that is bequeathed to them, they are generally compensated adequately by the removal of taxes on their labor and capital.

8. There Should be No Compensation for Loss of Value of Land Received by Gift or Inheritance.

There are two parts to the argument for this principle. The first part applies to land that comes from ancient patents of nobility. This is land that was assigned generations ago to conquerors or to friends of the monarch. There was a time when obligations were attached to the right to collect the rent of land, but that ended in the 17th century. There was generally little if anything socially useful about what the initial possessors of title did to acquire their titles, and in any event, if there were social obligation to them for what they did, these can be considered fully discharged. The rent of this land can be fully collected publicly without any need for compensation.

The second part of the argument applies to land that was purchased by the ancestors or other devisors of the current possessors of title to land. Compensation is not owed for the loss of sale value of these land titles because the current possessors of title received the titles to land as beneficences, rather than in exchange for money or other things of value. Society should not be held responsible for guaranteeing that a gift will turn out to be valuable. Furthermore, as mentioned in Principle 7, any obligation to compensate the devisors would have ended with their deaths. Similarly, by making a gift of title to land, the possessor of title ends the obligation of society to maintain the value of what was acquired through traditional purchase with properly earned funds.

9. The Owners of All Existing Capital Can be Called Upon to Finance Compensation When Individuals with Particular Obligations to Finance it Cannot Be Identified.

If it were possible to trace all past transactions, it would make sense for the obligation to compensate those who lose from the introduction of public collection of the rent of land to be assigned to those who appropriated land initially, to those who made gains on the sale of land in the past, and to those who received larger inheritances because of these events. But the past cannot be traced perfectly, and some who made past gains spent the gains on themselves and then died, leaving no one with a particular obligation to finance compensation. In this case, providing that the introduction of public collection of rent was unpredictable, it is sensible to distribute losses from introduction of public collection of rent in proportion to asset ownership.

10. At Some Point, People Have So Much that Further Compensation is Not Warranted, Even If it Otherwise Deserved.

Suppose that the compensation that is calculated for some person comes to £100,000 per month. That is simply too much. At that level of income, people should expect that they must take their chances that the evolution of the understanding of social justice will reduce the value of their assets. What should the limit be? I suggest a limit of £2,000 of compensation per month for persons without other income. Against this limit there would be an offset for benefits received from the elimination of other taxes. Compensation would decline as tax savings increased and would disappear entirely for persons with estimated tax savings of £2,000 per month or more.

11. Perfection is Not Possible; It is Proper to Leave Some Costs Where They Fall.

If an attempt were made to compensate for all losses of all deserving persons from introduction of public collection of rent, costs would be exorbitant, and in the end the goal would not be achieved. Since it would be unreasonably expensive to try to achieve perfect compensation, some losses of deserving persons should remain uncompensated.

III. A Principled System of Compensation.

The following system of compensation is consistent with the principles developed in the previous section.

Parliament enacts a law that, as of December 31, 1994, all taxes are abolished, and beginning January 1, 1995, all government in Britain shall be financed by public collection of rent plus charges on individuals for activities with costly consequences for others.

For the time being, contributions to government pensions based on payroll are maintained, pending the transformation of that system into one in which each person receives benefits corresponding to what he or she pays.

One activity with costly consequences for others is the ownership of property that is protected by the legal system. Therefore one of the fees that Parliament implements is a fee of 0.1% per year on all property, for legal protection. This fee is collected through a "self-assessed property protection fee". This means that all property that is to be protected legally must be declared. The owner must state the price for which he or she is willing to part with the property and pay a fee of 0.1% per year of that value. These self-assessed values will be used in the compensation process. A worksheet for calculating compensation and assessments to pay compensation is shown in Appendix I.

The first step in determining a person's compensation is to identify the person's prior gain from sales of land. This has two components. The first is the inflation-adjusted sale value of any land that was inherited and then sold. The second is the net inflation-adjusted after-tax gain on any land that was previously bought and then sold. The sum of these two components will be called "lifetime prior gain".

Next, through the self-assessed property-protection fee, one identifies the value of the person's fixed property (buildings) and the value of his or her other property. The value of the fixed property is compared with its market value on July 1, 1994 (before the property market reflected the possibility of public collection of rent). If the property was purchased after July 1, 1994, one would use as its initial value the lower of the purchase price and the value on July 1, 1994. This fall in value is recorded as the person's "gross loss from initiating public collection of rent". This is the amount that is potentially subject to compensation.

This gross loss is subtracted from the person's lifetime prior gain to obtain his or her lifetime net gain or loss. This amount is multiplied by the monthly prime interest rate to obtain the "annuitized lifetime net gain or loss".

If this amount is negative, then the person is eligible to apply for compensation. However, many people who are eligible to apply for compensation will not find it worthwhile to do so, because estimated gains from the elimination of taxes are subtracted from the annuitized lifetime net loss.

For a person who wishes to apply for compensation, the next step will be to compare the annuitized lifetime net loss with the upper limit on monthly compensation. I suggested a limit of £2,000 per month.

The next matter to be determined is the way in which gains from the elimination of taxes are to be estimated from income. There may be some research that estimates the total incidence of income taxes, profits taxes and the VAT as a function of income. For purpose of this effort, I will estimate total taxes as 15% of income plus 25% of income in excess of £500 per month. This amount is subtracted from the smaller of the annuitized lifetime net loss and £2,000. If this amount is positive, it is the monthly compensation to which the person is entitled. The amount would change over time as the person's income changed, and compensation would end when the person died.

It would be good to undertake a study based on the distribution of financial characteristics of British households, to determine what total compensation would be, and the rate at which it could be expected to decline as those who were eligible for compensation grew old and died. In the absence of such information, one can only speculate on the assessments that would be needed to finance compensation.

The first source of money to finance compensation would be assessments on persons with lifetime gains from dealing in land. Some rate, perhaps as much as 0.2% per month, would be applied to the annuitized lifetime net gain, for all persons for whom this amount was positive. Because this assessment would be independent of any future action, it would have no excess burden, as long as it did not drive the persons upon whom it was assessed into bankruptcy or other action that made it impossible for them to pay.

If an assessment of 0.2% per month was not enough to finance all of the compensation that people were entitled to claim, then an assessment would be made on all property. The rationale for this assessment would be that if individuals with a special obligation to compensate had been assessed as much as was reasonably feasible, then any remaining compensable losses should be distributed uniformly among the owners of property. The base for the assessment would be the total value of property that people had claimed under the self-assessed property tax. Since this base would be extremely broad, it should be possible to finance any remaining compensable losses with a tax on this base at an extremely low rate. To allow for the remote possibility that someone would have an excessive obligation to provide compensation, relative to his or her income, it would be specified that the total of compensation payments based on lifetime net gains and total assets could not exceed 25% of income.

This completes the specification of a system of compensation that would be consistent with principles developed in Section II.

Appendix I: Schedule of Compensation and Assessments for Compensation

Lifetime Gain from Sale of Purchased or Inherited Land ("Lifetime Prior Gain").... 1. __________

Self-Assessed Value of Fixed Property on Jan. 1, 1995 ("Starting Fixed Property")... 2. __________
Plus
Self-Assessed Value of Other Property on Jan. 1, 1995 ("Starting Other Property")... 3. __________
Equals
"Starting Total Property".. 4. __________

Value on July 1, 1994 of Starting Fixed Property, or, if acquired after July 1, 1994, the smaller of purchase price and value on July 1, 1994...................... 5. __________
Less
Starting Fixed Property (line 2).................................... 6. __________
Equals
Gross Loss from Initiating Public Collection of Rent...................... 7. __________

Lifetime Prior Gain (line 1)...................................... 8. __________
Less
Gross Loss from Initiating Public Collection of Rent (line 7)................ 9. __________
Equals
Lifetime Net Gain (or Loss)..................................... 10. __________

Times
Monthly Prime Interest Rate...................................... 11. __________
Equals
Annuitized Lifetime Net Gain (or Loss).............................. 12. __________

If line 12 is negative and compensation is sought, then:
Smaller of £2,000 and the negative of line 12........................... 13. __________
Less
Estimated Taxes (15% of monthly income plus 25% of monthly income in excess of £500 per month)... 14. __________
Equals
Monthly Compensation (if positive)................................. 15. __________

If line 12 is positive, then:
Lifetime Net Gain (line 10)...................................... 16. __________
Times
Regular Assessment rate .... 17. __________
Equals
Monthly Regular Assessment for Compensation......................... 18. __________

If further revenue is needed and line 4 is positive, then:
Starting Total Property (line 4)................................... 19. __________
Times
Special Assessment Rate....................................... 20. __________
Equals
Monthly Special Assessment for Compensation......................... 21. __________
Plus line 18 is
Provisional Monthly Total Assessment for Compensation................. 22. __________

Smaller of line 22 and 25% of Monthly Income is
Actual Monthly Total Assessment for Compensation..................... 23. __________

---

[1] An earlier version of these principles appears in Nicolaus Tideman, "Being Just While Conceptions of Justice are Changing," *American Economic Review* **82** (May 1992), 280-84.