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**The Role of Land Taxation in Tax and Land
Policy**

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The Lincoln Institute of Land Policy

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Land is a primary resource, and decisions about its use involve complex linkages between public policies and their impact on major economic, political, and social issues. Patterns of land use and property taxation affect, for example, employment, housing, infrastructure, and the environment. Policies for these areas, in turn, influence land use.

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To be accepted, the paper must address the Institute's topical agenda. Our programs focus on public policies that affect both the uses and values of land as a natural system and an economic resource. For example, many of our courses, research projects, and publications explore the relationship between land use planning or regulation and property taxation. In the United States, we work mostly on the land policy options facing state and local governments, and on the political and economic forces that constrain those options. In selecting working papers, we give the highest priority to manuscripts that clearly explain the significance of their conclusions for public policy and that focus on the complex interactions between public and private choices.

About the Author

Joan M. Youngman is a resident senior fellow at the Lincoln Institute of Land Policy as well as a research fellow in the Harvard International Tax Program. An attorney, Youngman studies the legal problems of valuation for property taxation. She is coauthor of a new book, *An International Survey of Taxes on Land and Buildings*, published by Kluwer.

I would like to begin by emphasizing how important the next two days' discussion will be to those of us working at the Lincoln Institute. We hope it will offer assistance in planning research and educational programs in an area that often gives rise to much conflict, in both the positive and the problematic senses of that word.

A part of the basic mission of the Lincoln Institute is rooted in the field of land value taxation. The writings of Henry George a century ago inspired John C. Lincoln's interest in land policy. The challenge to the Institute today is to pursue this portion of its mission with intellectual integrity, analytic rigor and policy relevance. This means accepting and dealing with the inherent tension between theoretical investigations and policy debate, and attempting to facilitate interchange between the two.

One source of both conflict and richness in this area is simply the array of multiple perspectives that enter a policy-oriented debate. Economic theory, empirical historical evidence, political acceptability, legal considerations and environmental effects are all relevant to a policy recommendation, and sometimes will be in conflict. At the most basic level, practical questions of how land actually is to be valued may be among the most pressing issues in the adoption of a land value tax, particularly if increases in rates are to place more pressure upon the accuracy of those valuations.

These factors insure that proposals for land value taxation will always engender conflict. This can be divisive and obstructive, but the challenge to the Institute is to utilize it as a dynamic and energizing influence, bringing together otherwise separate approaches and improving policy debate. Let me sketch out for you some of the specific questions and conflicts that I perceive in this area, and that I hope will enter our discussion over the next day and a half.

The first and most basic conflict is between the power of a simple idea and the limitations of a simple idea. The idea in this case centers upon the unique economic potential of a tax upon land value as a tax upon an element in fixed supply, which cannot be withdrawn from production in response to the tax, and so holds the promise of minimizing distortion in the revenue-raising process; the attraction of a tax upon an unearned increment, wealth properly claimed by the society that created it, a tax that to dampen land speculation and reduce land prices.

Balanced against this is the fact that no jurisdiction in this country confronts this question on a blank slate. The land purchased with the earnings of a lifetime's productive effort not being viewed in the least as an unearned increment. Recall the pre-1981 debates over what constituted unearned income ineligible for the 50 percent federal income tax ceiling. The simple idea of a theoretically efficient but politically unpalatable tax sounds uncomfortably like the poll tax that helped end Margaret Thatcher's term as prime minister. The poll tax, and its concomitant untaxing of residential property, gave expensive residential property much greater proportional tax relief than more modestly priced housing, and the political reaction took note of that fact.

The poll tax debacle also raises a question as to the role of capitalization, whereby the non-uniform portion of the tax upon property may be built into its price. Jens Jensen wrote in 1931:

The taxpayer, by virtue of the process of capitalization, has bought himself free from any calculable, unequal part of the tax, and as for the general or equal or uniform part of it, he bears that in common with others." To the extent the tax upon improvements has been capitalized, its abolition will be a windfall to current owners.

If the owner paid less for real property in anticipation of a tax liability, or if the imposition of a new tax is capitalized into a one-time reduction in value experienced by the current owner, what are the implications for the case for land value taxation, or the case against taxing improvements?

The tension between the one powerful idea and the many nagging questions, between Sir Isaiah Berlin's hedgehog and the fox, is echoed in the tension between the academic and public policy mainstream, on the one hand, and the committed followers of Henry George on the other. The small number of contemporary Georgists has diminished their general visibility, but not the intensity of their convictions.

Michael Kinsley, one of the most interesting contemporary admirers of Henry George, although certainly not a "Georgist," formerly editor of the *New Republic*, a syndicated columnist and regular guest on CNN "Crossfire," wrote in 1989:

In 1879, at age 40, [Henry George] self-published his brilliant, obtuse, eloquent, grandiloquent masterwork, *Progress and Poverty*. After a slow start it became a best seller and George himself became "the third most famous man in the United States" after Mark Twain and Thomas Edison, according to his granddaughter Agnes George de Mille (yes, the Agnes de Mille, the choreographer). He ran a legendary independent race for mayor of New York in 1886, losing to the Democrat but [overwhelming] the Republican, Theodore Roosevelt. By the [early twentieth century], however, George and his theories were almost completely forgotten. Since then the lamp has been kept lit, only dimly, by a small group of earnest cranks who tend to repel potential enthusiasts with their extreme zeal.

Their small numbers reduce their visibility to the academic community, but their zeal makes them an eager audience for the work of the Lincoln Institute. The mission and heritage of the Institute require it to give their fervent and often idealistic views a serious, responsive and substantive reply. If their straightforward and sometimes simplistic prescriptions are

taken seriously, they deserve a response: the elements that are correct should be endorsed, and those that are flawed should be identified.

We must first distinguish among at least four different approaches that can be termed "land value taxation": first, and most simply, a tax on land value; second, a tax on land value disproportionate to the tax on improvements; third, a confiscatory tax on land value; and fourth, the Henry George "single tax." This last is not of historical interest alone, for in many instances the zeal of contemporary Georgists stems as much from approval of the prospect of abolition of the income tax as it does from appreciation of a land value tax on its own terms. For example, in the March 1992 issue of *Incentive Taxation*, Steven Cord of the Center for the Study of Economics wrote:

[C]ompulsory taxes on workers and businesses force them to share what they produce with other and weaken respect for the *sacred right of private property* to the fruits of one's labor. It is robbery, pure and simple, even if the intentions are honorable.

Once respect for true property rights of others is weakened, then drugs, crime and moral laxity come marching in. Civilized society weakens. Land rent taxation can reverse all that. Labor taxation worsens it.

George himself believed his proposal would "raise wages, increase the earnings of capital, extirpate pauperism, abolish poverty, give remunerative employment to whoever wishes it, afford free scope to human powers, lessen crime, elevate morals and taste and intelligence. . . ." In light of these dramatic predictions, what is the historical record, one hundred years after the publication of *Progress and Poverty*? Again, there is conflict, here between triumphalist views of the converted, lack of interest by the others, and a puzzling ambiguity in empirical studies. The California Assembly Committee on Revenue and Taxation, with Harold Somers as consulting economist, wrote in *Taxation of Property in California* in December, 1964:

Early active champions of land value taxation were Henry George and the "single taxers." They argued that a single tax on land value, in addition to checking the holding of unimproved land for speculative purposes, would provide enough revenue for all government services. The debate on this proposal or related ones . . . has occupied Californians for many years. The "single tax" was put to a vote of the people of California four times in the period 1916 through 1922. Each time it was defeated overwhelmingly. In 1938 the measure reappeared on the ballot . . . [and] was rejected by the voters by the lopsided margin of 17 percent for, 83 percent against.

There have been very few major experiments with land value taxation in the United States. The City of Pittsburgh, Pennsylvania in 1913 adopted a graded tax plan providing for a changeover of property taxes from improvements to land values over a 12-year period. In Pittsburgh, land is now taxed at twice the rate of improvements. In commenting on the Pittsburgh experiment, the research director of the Urban Land Institute said [in 1962]:

In the City of Pittsburgh, wherein heavier land taxation has been in effect for nearly three decades, there is little evidence to suggest that slums have been discouraged by this tax; however, the capitalization effect, and the fact that the tax is only partially shifted toward land, make the proof of any contention difficult, if not inconclusive.

In a paper presented to the National Tax Association in 1964, Raymond Richman of the University of Pittsburgh wrote:

There is little evidence that the graded tax has been a significant stimulus to property improvement in Pittsburgh, or to urban renewal and redevelopment in particular.

We are fortunate to have Wally Oates here to discuss recent work on Pittsburgh, particularly in light of inconclusive statements of this type, which contrast so sharply with the views of those who advocate land value taxation in one of its stronger senses.

Land value taxation raises many conflicts and questions common to wealth taxation generally, in that it requires valuation of property, reaches nonliquid assets, and imposes a payment obligation where there has been no corresponding realization of income. On the other hand, what is the role of this one particular wealth tax in a nation where wealth taxation is nonexistent and even the estate tax, imposed upon the ultimate realization event of death, has atrophied to the point where fewer than one million people were estimated in 1986 to have sufficient assets to be subject to it? These considerations are particularly acute as increased reliance upon consumption taxes, either at the state level through sales taxation or through possible participation in the international move toward value-added taxation at the national level, heightens the importance of a balance to its regressive elements.

On the one hand, a land value tax, being imposed upon only one particular asset, is no wealth tax at all. On the other, it is a balance to the extravagant subsidies enjoyed by that asset in other forms of taxation, particularly in the federal income tax treatment of residential property. The 1993 budget OMB estimates of tax expenditures included these figures:

	(Millions of dollars)
Deductibility of mortgage interest on owner-occupied homes	42,900
Deductibility of property taxes on owner-occupied homes	12,605
Deferral of capital gains on home sales	13,925
Exclusion of capital gains for homeowners 55 or older	4,395
Total	73,825

Michael Kinsley wrote:

Above all, perhaps, George would observe how the developed world has been suffering in recent years from real-estate sickness. At times when the reward for happening to own a middle-class house has been greater than the reward for middle-class labor, this disease has twisted values, sucked away productivity, and redistributed wealth at random.

One particularly difficult conflict between land value taxation and political developments concerns treatment of open space and underutilized land. The theory of a tax severe enough to force utilization of land at its economic highest and best use is directly counter to the uniform movement in all fifty states over the past decades towards preferential assessment and lower taxes upon open space land in the urban fringe. Although the theory of land value taxation anticipates enhanced availability of open space, either through reduced need for sub-

urban development or reduced cost of public parks as land prices drop, the essential conflict between untaxing open space and greatly increasing the tax upon open space cannot be denied.

This political reality is all the more pronounced in light of economic criticism of the preferential tax systems which often make speculation cheap through the guise of preventing speculators from forcing small farmers off their land. In part this is because farmers are honestly and openly speculators in terms of wanting to realize their gains when land is ripe for development, and to avoid paying tax in the interim. In part this is because untaxing open land can permit developers to hold it off the market until the maximum profit is available. The complete success of these tax systems as a political matter is all the more impressive in the face of such criticisms.

Uncertainties as to the practical effects of preferential assessment upon land-use decisions raise again the question of how great an impact a tax at a given level will have upon land use, whether the policy under consideration be the untaxing of improvements or an increase in the tax upon land.

The question of open-space assessment highlights the more general environmental and political difficulty of a tax explicitly designed as an incentive to intensive development. Wherever there is a distinction between the highest and best use of land as an economic matter and the best use of land from another social perspective the coercive element here will be problematic in the extreme.

From one perspective, valuation of land might seem simpler than valuation of land and improvements together, for the values of adjoining properties should be consistent with one another in an explicable way. This type of coordinated mapping is not possible in the case of improvements, which bear no necessary relationship to one another.

From another perspective, however, land is far more difficult to value than buildings, having no reference to construction cost and being entirely dependent upon a determination as to highest and best use—with all the social conflict that reliance upon purely economic highest and best use would entail. Purchase price information from a buyer seeking title to land and building together rarely lends itself to a simple allocation between the two.

James Bonbright wrote in 1937, in *The Valuation of Property*,

Although a separate valuation of land and of improvements is called for by many of the statutes as well as by the practice of assessors, the fictitious nature of this separation is apparent. One simply cannot find the value, say, of the Stevens Hotel property in Chicago or of Mr. Schwab's residence in New York by adding the value of the ground devoid of the buildings to the value of the building devoid of the ground. The attempt to do so would result in the same error that would be committed were we to seek the value of Raphael's *Sistine Madonna* by adding the separate value of the upper half.

One recent example of the difficulty of land valuation concerns the assignment of market value for tax purposes to property contaminated by hazardous waste.

Another example concerns the proper treatment of intangible elements that enter valuation of land itself. California has been very clear that intangible elements not themselves subject to tax may properly enter into the valuation of taxable real estate in assessment. In a 1992 case involving the Post-Newsweek cable television system in California's Stanislaus County, the vice president of the system testified that in his opinion the value of the possessory interest was zero. An appraiser hired as an expert witness for the system calculated the miles of cable, measured the width of the lines (approximately six inches for trunk and distribution lines), converted this to square footage, assigned values of \$6, \$11, and \$2.50 a square foot to residential, commercial and industrial areas, respectively, and so found a full fee value to the land of \$2.4 million. Reducing this to reflect the possessory interest, not the full fee, and an estimated thirteen-year life for the interest, he assigned a value of \$500,000 to the possessory interest. The Stanislaus County assessor found the value to be \$46 million. The lower court held for the taxpayer, and the court of appeal reversed and remanded on the grounds that this did not take into account the enhancement in value due to the presence of an intangible, the cable television franchise.

This dramatizes the extent of the disagreement at the theoretical level as to the valuation of land, a disagreement that would be catapulted to center stage if the rate of land taxation were to dramatically increase.

Perhaps the most obvious instance of tension between land value taxation in theory and in practice concerns the political difficulties that face any tax proposal in an anti-tax age. News of the demise of the property tax has been premature, but not without some basis in fact.

Here is the property tax percentage of all state and local taxes in California:

1967 . . .	51.4 percent
1977 . . .	42.0 percent
1981 . . .	24.2 percent
1986 . . .	16.1 percent

Yet in 1990 the property tax supplied \$156.5 billion, or nearly one-third of all state-local tax revenue. General sales tax collections amounted to \$123.2 billion and individual income taxation to \$106.1 billion. The importance of the \$156.5 billion raised by the property tax in 1990 can be seen most dramatically by comparing it with the amount—under \$100 billion—raised by the federal corporate income tax.

In an era of endlessly straitened state and federal budgets, the existence of an autonomous revenue source has never been more clearly linked to the existence of independent local government. This clearly has significance in the case for land taxes which, even more than real property taxes that include improvements, being levied upon an immovable base.

This past year a National League of Cities survey of 620 cities and town found 54 percent of them running a current deficit in 1992, simultaneously drawing down their cash balances and cutting services. The National Council of State Legislatures found only seven states to

have budgetary reserves of 5 percent or more, that being the minimum level considered prudent by NCSL; the average state reserve had dropped from 9 percent in 1980 to 1.4 percent in 1992. Sunny Ladd's work with John Yinger on "America's Ailing Cities" tells this story in chilling detail.

What are the implications of a land value tax in this situation? Is it to be part of a package that involves untaxing improvements, in this fiscal climate?

This indicates some of the questions that I see as contributing to the difficulty, and the importance, of considering land value taxation. Michael Kinsley wrote, "What I like best about Henry George is the way he combines radical egalitarianism with an equally radical belief in free market capitalism." This type of independent thinking is certainly needed today, and one suspects that Henry George himself would not necessarily recommend the precise solutions today that he perceived a century ago. I think that the highest tribute we could pay to the power of his thought is to examine the case for and against land value taxation in the same free-thinking spirit, and I am glad that you could join us for considering the best ways to do just that.