

Pro-Growth Property Taxes

Government spending on programs to provide housing and to make homeownership more widely available nationwide, which has been advocated as a result of hyped reports of widespread "homelessness," is misdirected. Greater attention ought to be given toward reform of property taxation, which in its present form discourages new construction and other economic uses of available sites. Land-value taxation — which was originally proposed by Henry George more than a century ago — is an alternative to government spending as a means of promoting more affordable housing and economic growth. But its potential will be realized only if it is implemented as a genuine tax reform, not as another device for raising more tax revenues for the politicians to spend.

Current estimates of the number of homeless persons range from about 250,000 to more than 2 million nationwide. Whatever their actual numbers (the latter figure is almost surely an exaggeration), the homeless have not been helped by the billions of dollars spent so far on government housing programs. *Newsweek* observed (January 2, 1984) that in the past "the government's housing policies failed. Washington warehoused the poor in dismal high-rise projects [now slums — ed.], provided loans guaranteed to default and wasted billions in administratively inept programs that ended up subsidizing middle-class renters — and government paper shufflers — instead of the poor." Today, hundreds of thousands are said to be on "mind-numbing waiting lists for public housing" that is spoken for 20 years in advance. A Brookings Institution study estimated that by 1990 there may be a shortage of 1.7 million housing units that are affordable to low-income families.

Even so, the response of a number of politicians — as well as public and private social workers — has been to call for more public housing, more Federal aid for shelters, and extension of welfare benefits such as food stamps and Medicaid to persons "without an address." As in the past, such spending would fail to solve the problem. That some people do not have a home often reflects personal factors, rather than a deficiency of public or private charitable resources in general or inadequate housing in particular. In any event, the conditions of homelessness described by the media prevail in spite of the expenditure during the past 4 decades of tens of billions of taxpayers' funds through Federal urban renewal programs, revenue sharing programs, housing programs, and the like. To the extent that the problems of the homeless reflect a misallocation of resources, "throwing more dollars at the problem" is unlikely to prove effective. As with so many policy questions, a more useful approach would be to reduce the ways in which government fosters the misallocation of resources in the first place.

In our view, renewed attention ought to be given to a plan that has been suggested for more than 100 years: reform property taxes in order to convert them into an effective

means of promoting accelerated economic growth — especially in new construction — and of eliminating any special privilege associated with landownership. If implemented, this tax reform could not only remove barriers to housing the urban destitute (as well as the millions now living in slum tenements), but it could also make homeownership more available to the increasing number of America's equally publicized "other homeless" — the working men and women who want to purchase homes but cannot afford to at current housing prices and mortgage rates. Unless these conditions change dramatically, this group of "homeless" is destined to increase markedly and become a major policy issue in coming years.

An "Old" Idea for Today

In brief, a helpful property tax reform would follow the proposal outlined by the economist and social philosopher Henry George in his monumental work *Progress and Poverty* (first published in 1879). As contemporary followers of Georgist principles argue, under the provisions of current real estate tax regulations, maintenance and improvements to old structures and construction of new buildings is discouraged by high taxes on such activities. That is, in improving their structures or adding new structures, owners invite a higher assessment and tax on their property.

Low taxation of land in relation to taxation of improvements fosters (1) underutilization of land, and (2) a reluctance to construct and maintain improvements. That the supply of land is limited ensures that as population and economic activity increase, demand for land — and thus prices — will increase.* Low relative taxes on site values enable owners to leave it idle or in uneconomic use.† The smaller the land tax — which is the only direct cost to owners — the less incentive they have to use it productively or to sell it to someone who will. Yet, as the general population increases and economic growth result in a higher price for the land, the private owner receives the full benefit for a subsidized investment.

The subsidy is provided in part by payers of the larger tax on improvements to land. And the higher that these are, the more property owners are penalized for putting land to better use. Where taxes on improvements are much higher than taxes on land, owners are encouraged to forego maintenance and "pocket" both the receipts that would be spent for upkeep and the related tax savings attending lower assessments as structures deteriorate.

What can be done to reform this deleterious property

* In this discussion, "prices" refers to real prices, not depreciating paper-currency prices.

† Herein, "site" and "land" are used interchangeably and designate unimproved sites or raw land. Improvements to the site — even those so basic as drainage ditches, filling, recontouring, and the like — require an "investment" of labor or capital and for ease of discussion are included in "construction" herein.

tax structure? The editors of the neo-Georgist publication *Incentive Taxation* argue – in our opinion correctly – that state and local governments should legislate changes in order to *tax land site values at higher rates than improvements*. They say that land-value taxation would not only encourage development of unimproved land and better maintenance of existing improvements, but would also eliminate the special privilege associated with the ownership of land.

As Henry George argued in *Progress and Poverty*, those taxes necessary to finance warranted expenditures for common purposes ought *not* to be levied against either earned income or productive capital improvements that contribute to the creation of wealth or are themselves articles of production. Income taxes rob producers of the deserved rewards of their efforts. And taxes on either commodities or capital improvements discourage the creation of wealth. Land taxation, on the other hand, expropriates none of the rewards of labor but instead exacts a “benefits fee” of land rent that derives in large part from publicly financed projects such as roads, sewers, water lines, lights, and such that have increased the economic value of the land. In this regard, it is not a tax at all but a public charge for services rendered.

Visionary Dream or Practical Alternative?

Is this idea simply a visionary dream? Even though its critics generally agree that land-value taxation would not retard the production and distribution of privately created wealth, many are simply not persuaded that such a system of taxation is either feasible or equitable. They claim that there is no conclusive evidence that land-value taxation would accomplish what its proponents assert. They protest that there is no way in practice to distinguish site (location) value from improvement value of land. They say that present landowners have invested so much in already high-priced land that to expropriate land rents now would be grossly unjust. They suggest that a land tax would further increase land prices. Finally to be mentioned, they argue that such a tax would force retired persons (and others on fixed incomes) in prime locations from their homes. In sum, critics claim that land-value taxation may be fine in theory but it would not work in the United States today.

In our view, these reservations and objections have plausibility. Proponents of site-value taxation have not yet presented a clearly persuasive case. More work needs to be done, and such property-tax changes as Proposition 13 in California and Proposition 2½ in Massachusetts offer fertile areas for study. But objections always will be possible, and site-value taxation should not be judged against a higher standard of efficient implementation and defense than alternative forms of taxation.

It is hard to see how greater taxation of site values would pose problems that are much different from those already confronting real-property tax assessors (or other tax authorities, for that matter). They already must distinguish between value of land and value of improvements in their computation of general property taxes. As for the argument that land prices would likely rise even further – pricing more people out – the opposite seems more likely. The market value of each site or unimproved parcel of land reflects two things: the expected gross rent from the site and the tax on the site. An increase in the tax on a site would *not* increase its gross rent or usefulness, but it would *decrease* the net rent of the site by the amount of the additional tax – and so pressure prices downward.

The objection that present landowners who have paid high prices for their land would be unfairly deprived of anticipated rents has some merit. But Georgist-advocate

C. Lowell Harriss does not see this as an insurmountable obstacle. “Gradual change can accomplish much over the years,” he says, and thus argues for phasing in land taxation over many years. Indeed, even though complete data are lacking, the experiences of a number of cities in the State of Pennsylvania suggest that *gradual introduction* of the land tax can be accomplished without severe disruptions.*

Any threat that land taxation might pose to elderly homeowners likewise can be overcome through some form of deferred assessments. Payment of the full tax on such land could be deferred until the equity in the property was realized in an actual sale. Such a system already operates in some states such as California, where under the provisions of the Senior Citizens Property Tax Postponement Law retired homeowners may delay payment of the local property tax until the sale of the property – either when the owner decides to move or after settlement of the estate following death. In this situation, the owner is not deprived of the land, nor is the community denied its claim to the value of the land.

Beware of Imitations

It seems almost inevitable that whenever sound proposals begin to attract public interest as the failures of unsound practices become obvious, some people distort the sound ideas in order to serve their own special purposes. Some new proposals for land taxation, in whose defense Henry George’s name is invoked, are no exception.

Presidential hopeful Walter Mondale proffers his own version of Georgist ideas: “There are . . . a number of things which the federal government could do to further the taxation of land values. It could levy such a federal tax itself. . . . It could establish a new city based solely on land value taxation in order to demonstrate the feasibility of that principle.” It is desirable to demonstrate the feasibility of land-value taxation; it is unnecessary to spend who-knows-how-much in taxpayer funds to build a new Federal city for that purpose. As in Pennsylvania, more states could give local communities more flexibility in setting the proportionate share of real property taxes between structures and sites.

More importantly, any shift toward site-value taxation must indeed constitute a shift in the burden, not an increase in taxes. A great danger is that land taxation will be used as a cover in order to raise more revenue for the politicians to squander rather than as an aspect of tax reform designed to reduce government-induced distortions of free market decisions.

* In Pittsburgh, for example, taxes on land assessments were gradually increased from 4.95 percent in 1978 to 15.15 percent in 1983. During the same period, taxes on building assessments remained essentially unchanged – around 2.5 percent. Although many other factors were involved, this tax change coincided with an increase in new construction (as recorded by the dollar value of total building permits issued) of 590 percent. Nationwide, the comparable figure was around 85 percent.

IS THE SWISS FRANC WEAK?

From the early 1970’s through 1978, the Swiss franc appreciated greatly against the dollar, but since early 1979, the trend has been the reverse. This does not appear to reflect a fundamental shift in the policies of Switzerland versus those in the United States. Rather, Swiss authorities temporarily have given high priority to domestic employment and output, which have been buffeted by the falling value of the Swiss franc in terms of the dollar and by the rising value of the franc in terms of most other currencies.

In time, we expect the fundamentally less inflationary Swiss policies will be reflected in a renewed upward trend in the dollar value of the Swiss franc.

By the early 1960's, we concluded that the United States was so far down the inflationary path that deep economic problems lay ahead and the dollar would be devalued in terms of gold and some "strong" currencies. Based on studies of monetary and fiscal policies in various major countries, Swiss policies seemed less inflationary over time, significantly less than U.S. policies. In time the lower rate of inflating in Switzerland was expected to be reflected in an increase in the Swiss franc value relative to the value of the U.S. dollar. For U.S. holders of Swiss franc assets, the appreciating franc (in terms of dollars) would help offset the declining domestic purchasing power of the dollar.

Inflationary U.S. policies (and in other industrial countries) during the 1960's led to the collapse in 1971 of the Bretton Woods international monetary system of fixed-exchange rates. The dollar subsequently "depreciated" sharply against the Swiss franc. By the end of 1978, it took 160 percent more dollars to buy the same amount of Swiss francs as in 1971. This decline in the dollar's value in terms of the Swiss franc (shown in Chart 1B as the upward sloping section of the curve) was consistent with a well-substantiated proposition: Over prolonged periods, the exchange rate between two national currencies will adjust to differential rates of domestic general price rises so that the purchasing power of the currencies in terms of a broad group of goods will be approximately equal. (This is called the "purchasing power parity theory" of exchange rates.) As Chart 1A reveals, from 1973 to 1978 U.S. consumer prices rose much more than Swiss consumer prices. The increase was 140 percent in the United States (an 8.3 percent compound annual rate) and only 60 percent in Switzerland (a 4.4 percent annual rate).

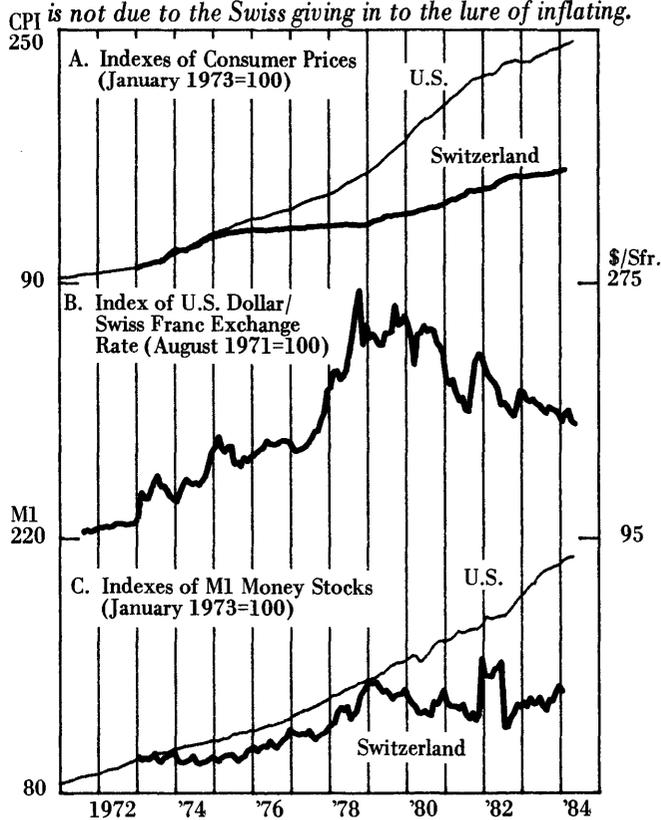
Since 1978-79, the foreign-exchange value of the dollar has increased in terms of most currencies, including the Swiss franc. In Chart 1B, this is shown as the downward-sloping portion of the curve, indicating fewer dollars (actually cents) per franc. After going from 23 cents per franc in 1971 to 68 cents per franc in 1978, the dollar subsequently rose in value to the current 44 cents per franc, recovering 18 cents of the prior loss of 45 cents per franc. Yet, the rate of general price rises on average has been higher in the United States than in Switzerland over this period, as over the earlier period. In the short run and the intermediate run, factors in addition to the concurrent relative price inflation must be involved in determining exchange rates.

Having few legal barriers to trade, Switzerland's situation illustrates the interplay between exchange rates and prices that affect all trading economies. Moreover, because international transactions (in goods and finance) constitute a relatively large part of Switzerland's economy, the effects of exchange-rate changes on Swiss domestic prices and output likewise are relatively large. So while relative trend rates of price changes affect exchange rates in the long run, exchange-rate changes affect domestic prices in the short run and intermediate run.

Switzerland imports approximately 23 percent of its consumer goods and services and 22 percent of its investment goods. Over 10 percent of Swiss imported goods are energy related. More than 8 percent of personal income is earned from abroad and 3 percent of the income is sent to foreigners. The European Economic Community (EEC) provides 67 percent of Swiss imports and buys about 50 percent of Swiss exports. Swiss trade with the United States

Chart 1
SWISS AND U.S. MONETARY AND PRICE DATA

As U.S. consumer prices rose more rapidly than such Swiss prices, the Swiss franc predictably appreciated against the dollar through 1978, but its subsequent decline has been contrary to theory. The little change in Swiss M1 versus the rapid rise in U.S. M1 since 1978 suggests the franc's fall is not due to the Swiss giving in to the lure of inflating.



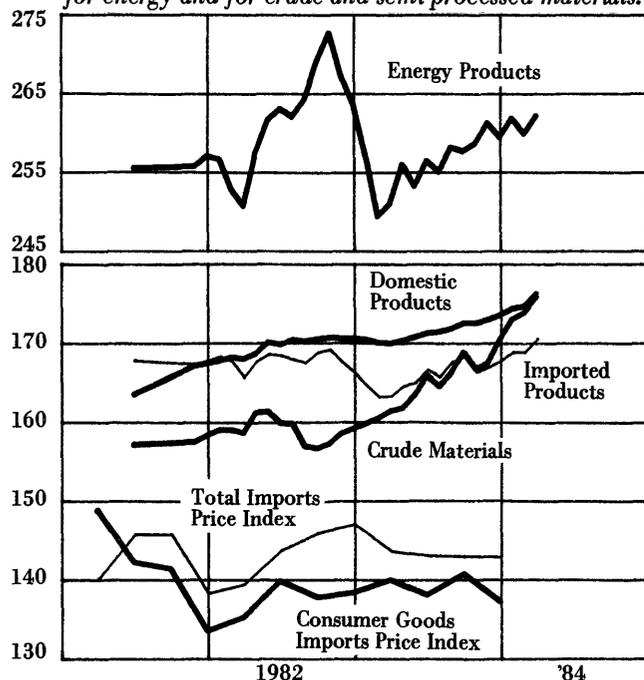
is less than a third of its trade with West Germany, but the importance of the exchange rate between the Swiss franc and U.S. dollar is larger than the U.S. trade share alone might suggest because of the dollar's international role in price quotations and payments for oil and other heavily traded commodities.

The large appreciation of the Swiss franc from 1971 to 1978 relative to the other major currencies partly offset the impact of the first "oil shock" on domestic producer prices, because fewer francs were required to buy dollars to pay the higher oil prices and to buy other currencies to pay for other imported goods. Recently, Swiss price indexes have been rising in spite of the Swiss franc's continued slow appreciation against the other European currencies. Of the components of the Swiss PPI (see Chart 2), the energy and commodity (crude materials) components increased most. With the majority of consumer and other finished goods coming from Europe, the effects of rising prices in Europe were offset by the appreciating Swiss franc. However, oil and commodity prices are rising in Switzerland because of the Swiss franc's depreciation against the dollar during 1983.

Forty-eight percent of the goods imported by Switzerland are raw, semi-processed, or energy-related materials. Since these products are processed further or are consumed in processing, price changes in these components (which constitute only about half of the import component) have a greater effect on the domestic PPI component than does the total import component. With raw commodities priced

Chart 2
SELECTED SWISS PRICE INDEXES

The appreciating Swiss franc in terms of European currencies has helped to hold Swiss imported finished goods prices little changed, but the weak franc in terms of the dollar has pushed up Swiss prices for energy and for crude and semi-processed materials.



in dollars, Swiss crude materials and semi-processed material prices thus have a heavy dollar-related cost factor and tend to rise as the dollar appreciates against the Swiss franc. In contrast, Swiss finished goods prices have a larger European cost factor, and have not risen as much or have declined as the Swiss franc has appreciated vis-a-vis the European currencies. This large European cost factor also accounts for the little change in the imported consumer goods price index, because Swiss consumer goods come from Europe for the most part. The producing sector has been faced with the twin problems of (1) having prices of their export goods rising in foreign markets and prices of European import goods falling in the Swiss market as a result of the rising value of the Swiss franc in terms of European currencies and (2) of having the domestic costs of imported raw materials used by their industries rising as a result of the falling Swiss franc value in terms of the dollar.

Swiss Monetary Policy

Swiss monetary authorities have earned the reputation for maintaining stronger anti-inflation policies than other central banks, and this reputation is reflected in the lowest interest-rate structure of any of the industrial nations. Nevertheless, Swiss consumer prices have drifted upward at rates of about 3 to 5 percent per annum. But when Swiss domestic price rises have threatened to accelerate toward 10 percent, the SNB (Swiss National Bank, their central bank) has acted to contract the money supply for extended periods of time. As Chart 1C shows, from early 1979 to the end of 1981 the M1 money stock decreased approximately 28 percent, and at the end of 1983 the M1 money supply still was smaller than at the beginning of 1979.

Yet, the money supply was not reduced enough to push the exchange rate high enough to offset the effect of the

rising exchange value of the dollar on Swiss domestic energy and raw commodity prices. To do so would also have raised the prices of Swiss products and services denominated in other currencies, making them less competitive in the international market and further hurting employment conditions in Switzerland. Short-run employment concerns associated with volatile exchange rates accounted for the unusually rapid Swiss money-supply increases during 1977-78 and 1981. In each case, the SNB subsequently acted to remove most of the increase.

Dr. Georg Rich, Director of the Economic Studies Department of the SNB, summarized the SNB's approach thusly:

Since, in the short run, Swiss monetary policy is likely to impinge on the real sector of the economy, the SNB has not been oblivious to the output and employment effects of its policy actions. . . . The SNB from time to time has taken account of the employment situation in devising its monetary policy . . . has largely followed a gradualist approach to fighting inflation and has refrained from shock therapies of the kind administered in 1973 [keeping a tight rein on M1 growth - ed.] . . . [The SNB] decided to shift temporarily to an expansionary monetary policy in order to forestall a slump in output and employment that it expected to occur as a result of an excessive upvaluation of the Swiss franc. . . . [This] policy shift was responsible for the marked acceleration of base-money growth in 1978 and was followed by a new spurt of inflation.*

The eventual consequences of a monetary policy forever aimed at boosting employment in the short run is the ratcheting upward of general prices and eventual economic stagnation. But because the Swiss inflate less, and frequently remove some of the excess money, Switzerland has experienced less harm from inflating than have other industrialized nations.

Consistent with the purchasing power parity theory, the Swiss franc has continued its long-term appreciation in terms of the other European currencies, but since the monetary turmoil of 1978-79, the Swiss franc has depreciated in value against the dollar. This intermediate-run depreciation of the franc may have been partly a correction of an earlier overreaction, partly a result of a "safe haven" demand for the dollar in response to economic and political uncertainty in the Middle East and Western Europe, and partly a restoration of demand for the dollar because of a perceived "anti-inflation" policy of U.S. authorities over the last 5 years. The "weak" franc since 1979 thus does not seem to reflect a shift in the fundamental commitment of Swiss authorities to preserve the buying power of the Swiss franc. This, combined with our view that the United States has not fundamentally shifted away from its inflationary policies, leads us to conclude that it is only a matter of time before the Swiss franc again begins a trend of appreciation in terms of the U.S. dollar.

* "Is Swiss Monetary Policy Really Monetarist," paper presented at the conference, "Money: A Search for Common Ground," Lugano, Switzerland, April 27-28, 1984. This conference was sponsored by Progress Foundation and organized by AIER.

PRICE OF GOLD

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