

A REVIEW OF THE GEORGIST TAX REMEDY FOR AUSTRALIA

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ABSTRACT

Rent theory has been associated historically with the suggestion that land rent is a most suitable basis for public funding, giving rise to the single tax movement of Henry George. The political fortunes of the latter have been singularly unfavourable, and have tended to draw attention away from systematic study of rent theory.

The recent trend in many texts has been to enumerate a set of shortcomings with rent theory that often owes more to a provincial rejection of the single tax proposal than to an informed and balanced critique of the apparent target. This paper reviews the fundamental political economy of land tax with special reference to Australia to demonstrate a separate set of shortcomings, not associated with rent theory. In this way the political impracticality is explained without challenging the validity of rent theory.

KEY WORDS

land tax, property theory, Henry George, tax reform, rent theory.

INTRODUCTION

The concept of using the rental income from land as a source of public revenue has broad cultural and historical precedents (Small, 1997a; Small, 1997b). The identification of land value with social externalities was first explicitly used for public revenue by King Charles II in London (Small, *et. al.* 1996) and was the basis of feudal public revenue well before that time. Its empirical success as the principle form of public income has been noted by several historians and economists (Belloc 1937/1973, Charles, 1991; Chesterton, 1917/1951; Cobbett, 1824/1988).

The theoretical support for the taxation of land proceeded from rent theory which was developed concurrently with free market theory by theorists such as Ricardo, Smith, Mill and George (George, 1992, 1879; Mill, 1848/1970; Ricardo, 1817/1973; Smith, 1776/1975). Henry George (1839-97) did not so much extend the theory as focus it and propagate its merits politically. His system of political economy deviated little from Adam Smith, except for promoting Smith's discrete suggestions regarding the merits of the taxation of land to be the centre-piece of a political movement commonly known as the Single Tax Movement. The fortunes of the single tax movement entrained rental theory and as the former failed politically, the latter faded from significance within the body of economic knowledge.

Today, supporters of the social appropriation of land rent are usually identified as Georgists, respecting George's prominence in promoting the notion, but obscuring the fact that its theoretical and historical roots are far deeper than the nineteenth century American. Proponents of land tax note that land's rental value is produced almost entirely by the surrounding social fabric. Assuming that it is just for the producer of a thing to have title to it, it follows that the rental value of land naturally belongs to the community that produced it. A land tax equal to the full rental value of the unimproved site is therefore natural justice. Kavanagh (1995) provided data indicating that the total value of land rent in Australia was very close to the total of all taxes, and could therefore replace most other taxation. The expression *full land tax* (FLT) will be used in this paper to refer to such a complete community appropriation of site rent, replacing most other taxation.

Despite its simplicity and apparent validity, this essentially moral observation has suffered

a century of powerful attack and almost universal rejection. Today most standard economics texts give scant attention to the Georgist position and usually conclude discussion of his ideas with a clichéd litany of criticisms of rent theory (Barlow, 1958; Harvey, 1987; Kieve, 1977; Samuelson, 1973). Georgists correctly retort that many of these criticisms are ill founded misunderstandings and some even defy common sense, but they persist.

While the Georgist position pivots on FLT, Young has demonstrated that in all other respects it recommends a strong libertarian position indistinguishable from what is currently referred to as *economic rationalism* (Young, 1997). The Land Values Research Group's 1996 submission to the Australian Tax Summit succinctly summarised the position, as well as signalling the continuing Georgist political intent to re-assert the single tax argument. By critiquing these arguments, this paper will demonstrate that the single tax's shortcomings are crippling, though not due to rental theory, thereby liberating interest in the latter from its Georgist associations.

ECONOMIC SHORTCOMINGS

George's concern over the justice of private rent taking has certain theoretical merit, though his tax remedy encounters a separate set of justice issues that will be dealt with separately. His contention that it constituted the only significant anomaly in the free market system as practiced in his time is problematic. Other analogous anomalies do exist and developments over the last century have increased their importance to the extent that FLT would exacerbate the type of inequalities that contemporary Georgists seek to control

George refined Ricardo's law of rent, recognising that in a perfectly competitive economy rent taking by land owners would normalise the returns to labour and capital. Harrison has provided evidence of this mechanism (Harrison, 1983). This implies that all economic rent will eventually go to land.

In George's day this was a dubious assumption, and today it is even less defensible. The vast majority of actual markets are best described as *imperfect*. This is no more than a covert recognition of the perennial existence of economic rents accruing to entrepreneurs. Economics students are now taught that there are four factors of production, land, labour, capital and

enterprise, precisely to lend moral weight to the very motivation of capitalism, the private appropriation of economic rent by the entrepreneur. It recognises the stable existence of economic rents that are not siphoned off to land.

If the entire economic rent is destined for land, as George suggested, and all of that rent is the natural property of the community as Georgists argue, then these intermediate rent takers are stealing from the community just as much as many Georgists believe the landlords are. This is no more than a consistent explanation of the widely held rejection of economic rents evidenced by such things as market theory itself, the existence of anti-trust (restrictive trade practice) legislation and public distaste for monopolies. George recognised this when he railed against what he called *spurious capital* or even *anti-capital* (George, 1879/1992). Other writers in the Georgist tradition have echoed this distaste for parasitic privilege, indicating that it works against the general good of society (Brennan, 1971; Charles, 1991; Dowe, 1989; Pearce, 1987).

Economic rents capitalise into capital gains when markets are confident of future growth in returns. Recent economic cycles have reflected this with three economic rent takers, equities, land and money, all tending to peak before crippling the productive sector and heralding recession.

George and those who have followed him have tended to excuse other rent takers, believing that they will be dissipated in one of the three following ways:

- 1) Non-land economic rents are only transitory and will be competed away if the free market is permitted to flourish.
- 2) Most economic rents will be eventually absorbed by increased land rents.
- 3) Any residual non-land rents that are taken as super-normal entrepreneurial income will be absorbed by land as prosperous entrepreneurs occupy more valuable land.

Although each of these processes operates partially, much escapes. They signal a recognition that non-land economic rent taking is dysfunctional, but imply that it is not a significant problem. Several lines of evidence indicate that perennial economic rents form a significant and problematic

component of most modern free market economies. By definition, for example, normal profits do not produce real equity capital growth. Real capital growth of equities must be the capitalisation of super-normal profits flowing from economic rents, hence speculative market bubbles constitute pre-emptive economic rent taking. History shows the damage that unrestrained share speculation can cause, such as the South Sea Bubble, and the widely recognised fact that economic recessions usually follow bubbles in the speculative equity and property markets.

Existing capital gains tax partially traps share and land speculation for the community, thereby dampening their effects. Replacing it by a FLT would diminish public appropriation of these economic rents and speculation in these areas would be further encouraged.

It is widely understood that one of the reasons for the contracting Australian tax base is the success with which companies and wealthier individuals have been able to write down their taxable incomes. Georgists argue that this would be overcome by FLT. However, while land tax is difficult to avoid, these entities would no longer have to disguise their non-land economic rent earnings and would be encouraged to minimise their Australian land use, thereby further reducing their tax commitments.

Multinational companies would be well served by FLT, although their likely responses would impact negatively on Australia. At present they tend to escape significant company tax through strategies such as transfer pricing, contributing to the public purse more through indirect taxes, especially wholesale sales tax. Their local manufacturing capacity is a major part of their local land use. Were sales and import taxes replaced by FLT, the rational decision for these organisations would be to liquidate their local land holdings and move their manufacturing capacity off shore. Combined with just-in-time inventory systems, such a move could almost eliminate the taxation liabilities of these entities through the minimisation of their land use, without diminishing their local sales.

The economic rent would then be almost entirely drained out of the country, as well as the socially valuable productive employment. The exodus would reduce local rents, further compromising the value of FLT.

While multinational manufacturers may choose to relocate off shore, local manufacturers will be subject to the full weight of FLT. This can only operate against them. The rural sector is currently experiencing considerable hardship due to the 'level playing field' economics that has closed many down and stimulated the sell out of individual farming units to massive agribusiness corporations. It will be particularly hard hit by a transition to FLT. While it is possible that the eventual benefits under a flexible, productivity based, FLT could lead to a strong and robust rural sector, this is not realisable in the current Australian context without either massive oppression of rural land owners or massive compensation.

Farm owners illustrate the fatal flaw in transition to FLT. Their industry is most conspicuously land based and the land value constitutes the major part of the farmer's business investment. Like most Australians, land purchase has been a major and near crippling financial expenditure. However, FLT would nationalise the rental stream that is the foundation and object of that investment, without compensation. By adding a significant new charge, possibly on top of existing debt, and dissolving the value of land investments, local farmers could not possibly compete with imports that would come free of any taxes.

There is no point offering the elimination of income tax if there is no domestic income. FLT may have the capacity to replace most other taxation, but it will only achieve this through massive and inequitable short term distortions in wealth distribution and long term disincentives for productive local land use.

A second major non-land sink for economic rents is the finance sector. Like land, money has no cost of production and hence, income from money has no intrinsic claim for a return. Real interest rates, once risk and inflation are adjusted for, are purely the result of an imperfect market, where supply is limited and demand is great. Panico, enlisting for support economic theorists as diverse as Keynes and Marx outlined the way that interest rates are best explained as a purely social convention (Panico 1988). This is a subtle issue and one that is wrapped in a controversy that reaches back almost to the dawn of civilisation. It is no accident that those cultures that have prohibited private rent taking have also tended to prohibit usury (interest on money).

Georgists often quote Rogers (1884/1949), citing pre-renaissance England as an example of the success of a society that raised public revenue from land rents. They appear to ignore the fact that not only was land the source of public revenue, but usury and prices above the 'just price' (i.e. economic rent taking) were sanctioned as immoral as well.

Regardless of the morality issues, which will not be engaged here, the historical facts indicate that banking exerts a massive and often distorting effect on economies. It deserves restraint. Ford has succinctly analysed the way in which Argentina, a country that a century ago had much in common with Australia, is now little more than a third world economy due to no more than its dependence on foreign finance (Ford, 1960). In analysing Mexico and its relationship to US Federal Reserve policy, Grieder has illustrated a more recent example (Grieder, 1987). The current threatened collapse of previously prosperous nations in South East Asia likewise appears to be linked in no small way to international finance.

The Georgist interpretation of problems in these countries focuses on inequalities in land access as the reason for their economic demise, revealing an extraordinary naivety. There are no examples of countries going bankrupt as a result of the absence of FLT. However the literature on the third world debt crisis alone should be sufficient to indicate that stiff control of the finance sector is necessary if this exposure is to be controlled. Georgist theory preaches radical free trade, which when combined with the elimination of other taxes through FLT, would dissolve important controls on international financial manipulation and exploitation.

LAND USE IMPLICATIONS

Land tax proponents propose a curious solution to the problem of taxing banks. Since banks tend to occupy the most prestigious city sites, FLT would have the effect of taxing them relatively heavier. However, the relative weighting of the tax collected due to their penchant for prime CBD sites bears no relation to the share of the nation's income that they collect or control. Furthermore it would not vary in relationship to changes in that share.

Likewise, their tax obligation could be easily minimised by opting to rationalise their CBD

land usage. There are some benefits to decentralisation, and FLT would undoubtedly encourage them. However, in public revenue terms it would have less predictable results. Many CBD occupants may decentralise at least part of their operations, depressing rents and hence public revenue, while international organisations may simply quit land hungry operations in Australia.

At the other extreme, corporations manufacturing off shore could declare their profits tax-free from head offices located in small towns, turning Australia into an international tax haven.

The pressure to use less land will also impact on individuals, however the benefits are rather dubious. Despite the strength of public statements by environmentalists and planners, many people do not appear to believe that the consumption of land for personal use is a social evil. Land is not consumed in use at all. Urban land, the most valuable in the community, is singularly unaffected by use, as demonstrated by urban renewal. Most individuals when given the choice opt for more land to live on rather than less, unless pressures such as employment and price distort a free decision. If the community is the sum of these people, then its greatest utility comes when it offers its members more land rather than less.

However, from the perspective of those who provide and maintain infrastructure, and who have lost sight of the nexus between the source of their income (people) and its destination (people), compact urban spaces usually appear most desirable. Concentrated land use may consume fewer tax dollars, but it is the one situation from which most individuals seek to escape. While the wealthy may enjoy inner city residences during the week, they have also shown a perennial desire for spacious non-urban retreats. The middle classes have tended to resolve their desire for space by locating their one residence as a leafy compromise between back yard space and commuting time.

It is simply untrue to conclude that intensive land use, as will result from FLT, is a social good when it opposes the best interests and desires of the great majority of citizens. Australians particularly value the right to a reasonable share in the land, a right that would be stunted by FLT.

RENT NATIONALISATION AND MORALITY

Freehold title is distinguished from leasehold by the right to the private collection of land rent. Although that may constitute the private appropriation of value produced by the community, its uncompensated resumption cannot be effected without harm.

The Crown is a legal entity standing for the community and has the ultimate title to property. Like other legal entities it has the right to own, and also to dispose of, by sale or gift, those things in its possession. If it freely sells things in its possession for a price that it considers acceptable, then it cannot later claim an injury. Once licitly sold, it has no rights to the things alienated, even if it should act gratuitously so as to benefit the new owners.

The reality is that in Australia, as elsewhere, the state has alienated, through sale or gift, the right to the rental income of its most valuable land through freehold grants. While it is incontestable that the community has contributed in no small way to the later enhancement in value of that land, the community has surrendered its title to it. While it may be complained that the state only charged nominal prices for these lands, they were freely determined and hence licit.

There is no evidence that the government was coerced or acted in poor faith in granting freehold. Rather, there appears to have been the belief, especially in the early colonial days, that the provision of inexpensive freehold land would be a responsible way of stimulating prosperity for the community of the day. The provision of inexpensive freehold land was therefore culturally consistent and in no way corrupt. Once alienated as freehold, the right to all rental income, regardless of origin, was transferred to the private owners.

The constitutional right to *just terms of compensation* for the resumption of land opposes FLT. As the public appropriation of the rental value of land, FLT would be the resumption of a key element of that bundle of rights that constitutes freehold title as it has always been accepted. Just compensation would equal the market value and leave a title that would be essentially a perpetual leasehold. Anything less would be theft.

Conversely, statutory estates (state leaseholds) should already collect the land's full rental value for the state, which is exactly the aim of

FLT. This accounts for over 40% of Australia's land. Here the state has not alienated its right to rental income, but in virtually every case has allowed political pressure groups to constrain rentals to very low levels, creating private *freehold-like* interests that have fuelled other problems (Small, 1998). Brennan's (1971) analysis of Canberra indicates how rapidly this unravelling of FLT can proceed. Peace (1933) has shown how the demise of Medieval feudalism was partially effected by a similar subversion of what was in effect a FLT system. The political realities are that if FLT were introduced, over a period of time its effectiveness would be dissolved.

CURRENT TAXATION PHILOSOPHY

The current taxation regime relies on the assumption that all members of the community should contribute a part of their productivity to fund public activities. Most land economists familiar with the issue, including Georgists, agree that all taxes are eventually paid out of land rent. Also, income tax intends to trap all economic rents, either as income or capital gain.

Land rents are currently taxed as income, hence a significant proportion of rent is already being taken and speculative property profits attract capital gains tax. Income tax is indiscriminate between land and other speculative incomes which is an advantage over FLT. The one virtue of FLT is its taxation of the entire economic rent accruing to land, but it does this at the expense of releasing the others.

The fact that current income tax legislation is cumbersome and riddled with loopholes, is not sufficient reason for its replacement - it is an incentive to repair it. George's single tax remedy is better recognised as a special case of the taxation of economic rent. Its true value lies in illuminating the importance in sound tax reform of explicitly targeting economic rents as the tax base and relaxing taxation on normal incomes. This could be achieved by taxing capital gains at a higher level than other income. Even then, the gains should be used cautiously in reducing other taxes so that it does not allow the further draining of Australian income off-shore, which has proven repeatedly over the last century to be the greater threat to national economic security.

CONCLUSION

Although Georgist theory may be a valid tool for understanding land value and the conceptual appropriateness of land tax, its taxation prescription is not appropriate for contemporary Australia. Despite highlighting the validity of taxing economic rent, its treatment is inconsistent and reliance on land tax would release many other economic rents from contributing to the public purse, putting tax equity back rather than forward. These anomalies would promote an array of dysfunctional outcomes, including

international tax evasion, the further flight of local manufacturing, unemployment, poor land use and undue exposure to international financial forces.

Politically, there are specific constitutional difficulties with a Georgist land tax and examples of its application demonstrate that it is highly vulnerable to political manipulation. While freehold may be an unfortunate choice of land tenure, its forcible dissolution through land taxation constitutes a more serious societal harm.

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