Russland: My MS

DRAFT

LAND PRIVATIZATION IN POST-COMMUNIST NATIONS WITHOUT GIVEAWAY

I. Introduction:

~~A.~~ An emphasis on synthesis. Writer does not favor recreating Soviet economy in our image, even were that possible.

~~A~~ ~~1.~~ We have problems too. Same problems that turned off Marx in The Gilded Age, led to Populism and Progressive Movement in U.S.A., Fabianism and The Labor Party in U.K. Same problems that terminated The New Era of the Roaring 'Twenties, led to The New Deal. History repeats. Problems from the crass excesses of The Deregulated 'Eighties may well lead to another such reaction in the near future.

~~B.~~ ~~2.~~ Some of our problems: rising homelessness, falling affordability of housing; persistent unemployment; rising inequality in distribution of income and wealth, especially wealth; growing obsolescence of American industry faced with foreign competition; low domestic capital formation; capital import, alienation of American wealth; level or falling real wage rates; persistent high crime rates; growing underground economy, tax-avoidance as way of life; anomie and substance abuse; dangerous dependence on imported oil; etc.

~~C.~~ ~~3.~~ We have shown that personal interest is the irreplaceable motive power of production and progress, but also, in our periodic crashes and reactions, it can lead to ugly, inhumane excesses and abuses. The goal here is to combine capitalist drive and efficiency with socialist egalitarianism in an optimal synthesis.

II. Why Socialize Land Rent?

A. Why not just sell off?

Few now question that the land of Russia belongs to the whole people of Russia, through their government (just as the Federal domain of the U.S.A. belongs to all Americans through their Federal government). We do not now address which Russian government owns what lands, a question for Russians.

A simple method of privatizing without abandoning the public claim is selling title to the highest bidder, free and clear of reserved sovereign claims like taxes. Why not just cash in up front and let the market take it from there? Many American economists have pushed this policy at home, especially since 1980. They have not denied the prior public claim to land rent, but sincerely seen this as the best way to assert it and free the market from the meddlesome, irrational hand of government in the future.

There are many reasons to reject this policy.

1. You cannot sell off an entire nation quickly at other than fire-sale prices. A massive sale is a giveaway. Normal turnover in the U.S. land market is well under 4% of parcels, and much less than 4% of value (small parcels turn over faster). Dumping 100% in any short period would immediately soak up all available capital funds, leaving no purchasing power for the rest, let alone to finance development and working capital.

2. In those conditions, most land would be bid in by a very small number of very wealthy buyers looking toward use or resale in the distant future, otherwise known as land speculators.

3. Government would suddenly be swamped with excess cash flow. Politicians being what they are these flows would be regarded as current income, and dissipated accordingly. Consider the use of national land sales in the U.S.A. in the 19th century.

4. Government needs revenues in perpetuity. If it abandons land as a source of revenue it must resort to other sources, typically taxes on sales and consumption (such as those that helped trigger the deposition of Nicholas II in the first place). Almost all taxes on sources other than land are of the nature that "shoot anything that moves," with the familiar effects of depressing production, misallocating resources, promoting criminal and other underground economies, and lowering capital formation.

5. Private capital being scarce in Russia, most land would be bought by aliens. It is doubtful if any nation can keep its sovereignty, and meaningfully represent its own citizens, when most of its real estate (the regal estate, historically) is foreign-owned. In pre-commercial times no one could own land in most countries without swearing personal fealty to the sovereign, who recognized the link between land and power. Alien ownership was common only in conquered lands; it is a form of conquest.

5. It can be shown the land market works better, on an ongoing basis, if land remains subject to regular taxes or other charges in perpetuity.

6. It can be shown that counterproductive rent-seeking behavior, in the most primal sense, is maximized when land is simply privatized without the state's reserving substantial servitudes, especially tax power. Private rent-seeking would dominate planning, timing and extending infrastructure of all kinds.

7. Local governments, traditionally weak and dependent in Russia, also need revenues in perpetuity. Perhaps as important as promoting capitalism in Russia is promoting decentralization of government power, which entails building up local power with its own independent financial sources.

8. A means is needed gently to pry loose surplus land from government agencies like ministries in charge of production. Forced sale is drastic and, like the death penalty, unlikely to be enforced except in the most

extreme and flagrant cases and after extended study. The alternative of ongoing land taxation, (without exempting state agencies), is more likely to work in practise. Taiwan affords a precedent.

These nations are not starting with a clean slate. Land is tenured, it is controlled by existing agencies that are just as possessive and righteous as the U.S. Forest Service and the University of California (50,000 acres all used "for educational purposes"). These agencies have important core functions. The #1 priority in privatization is to induce them to identify and sell their surplus lands, while retaining and making better use of their essential lands (e.g. The University might focus on teaching students).

9. Public acquisition of lands for r.o.w., parks, schools, military bases, reservoirs, watershed protection, etc. becomes much more costly when all land is privatized first.

B. Functional Reasons

1. Taxing land lets us avoid taxing production, exchange, work, saving, investment, etc. Taxing all those other things has demonstrated negative economic effects.

2. Taxing land holds down the purchase price, easing and democratizing entry.

3. Taxing land drains cash from sleeping owners of surplus land, awakening them in the most compelling way to the otherwise overlooked opportunity cost of their surpluses. A cash drain has wealth and liquidity effects that are demonstrably more potent than mere opportunity cost in driving land to its highest and best uses.

4. Taxing land lubricates the land market which otherwise has a demonstrated propensity to turn to glue.

5. Taxing land inhibits all non-commercial uses of land, but only in those locations where land has high commercial value. It tends to relocate, rather than destroy, non-commercial uses to less central locations.

6. Taxing land discourages the currently powerful motives to hold land merely as a store of value and hedge against inflation. Taxing land discourages landowners from their current practise of borrowing money and then joining and leading the too-powerful pro-inflation lobby.

C. Ethical Reasons

Once land is privatized, unearned income begins flowing, and losses occurring. Expectations change daily in a dynamic world, so unforeseen windfalls and wipeouts based on exogenous forces soon take over from original expectations on which initial sales prices were based. That is the nature of land.

Incomes have been divided into "Earnings, Findings and Stealings." Historically, much land rent has been a "stealing." On the other hand, in the present proposal, if buyers pay government up front for land, later rents are a sort of earning ("sort of" because there remains a question of where the buyers got their money initially). There

remain, however, windfall rents which are "findings." Findings are just as non-functional socially as stealings based on force and fraud.

A major source of such "findings" is developing infrastructure, which brings benefits to specific lands (and may remove them from others). Shifting from communism to capitalism will entail a massive change in infrastructure - e.g. the provision of roads and utilities for the small private farms that will supplant the present handful of collective farms. The capital to finance this infrastructure presently lies sleeping in the lands to be served, whose rise in value will more than pay for the capital provided it is tapped to do so. If it is not, someone else will pay to give a windfall to the landowners, a most unethical procedure.

D. Political Reasons

It makes sense for a central government to tax the rent from rich regions, and distribute it. This is what can bind a nation together and overcome (if anything can) ancient ethnic loyalties and particularism.

The method of distribution should be per capita (or some surrogate like a.d.a. at school, or history of military service). Nothing that is purely economic seems better calculated to bind citizen to nation. It has the great added value of avoiding the geographic maldistribution of population that results when rents are collected just locally, and redistributed solely in the form of local public services.

The alternative method of distribution, "regional equity," is a proven recipe for dissipating rent and bankrupting rich polities. Regional equity is also a cloak for imperialism, a way of holding on to distant and marginal provinces. Better all around to let them go and settle for a smaller swatch of your color on the world map.

Distribution to local governments is also a formula for overcentralization, aborting development of local self-government and decentralized power. The U.S. model of the 18th-19th centuries is worth emulating here. Sovereignty in the Federal system was shared between central and state governments (territories, earlier). States then set up counties, generally on the principle of nulle terre sans seigneur, i.e. without leaving much unorganized, hence untaxed lands. The states' power of taxation was delegated to counties and, as they incorporated, cities.

A key factor is that little or no aid (other than military) was extended from central to local governments as such. They had the power to tax property, and they did. They had little power to tax anything else.

In this way, decentralized political power grew, saving the U.S.A. from the evils of overcentralization that have stifled democracy in so many other countries.

Colin Clark has sketched out a system of combining the above decentralized system with a centralized sharing of rents. Let local jurisdictions be ranked by land value per

capita; let central government impose a land tax that is graduated according to that ranking, falling to zero for those with the least land value per capita.

III. How to Collect Land Rent?

A. Up-front or Over Time?

This is covered in II,A, above.

B. Leasing vs. Taxation

Leasing and taxation are alternative methods of asserting the public equity in land on an ongoing basis. Most taxes are closely analogous to certain standard lease provisions, and vice versa.

Taxation has one quality that makes it vastly preferable to leasing. That is the annual revaluation of land for tax purposes, based on current information derived from comparable properties.

Leasing on the other hand binds the lessor to fixed terms negotiated in advance. This is inherently biased for lessees, who can always walk away from an unfavorable lease. A lease is basically an option to use land provided its economic rent turns out to exceed the contract rent. In addition, private lessees, being private, are more highly motivated than median public employees, and likely to outnegotiate them. Bribing and corruption are not unknown.

The history of public leasing is generally one of failure to collect the full land rent.

Annual revaluation of land for tax purposes might seem to impose extra uncertainty on lessors, compared to fixed terms of a lease. However it is only the amount of tax that is uncertain, not the principle of it. Furthermore, the principle is such that the tax only rises when exogenous factors raise the earning potential of the land.

"Uncertainty" is not always and inherently bad. Life is uncertain, economic tides are uncertain, and optimal land use calls for constant adjustment to uncertainty. This means the most fixed, durable improvement should rarely be encouraged, it is likely to obsolesce well before it wears out, like the C&O Canal. In dynamic times and places, it is desirable for builders to anticipate fairly early demolition and renewal, and build accordingly.

C. Fixed payment or participation?

The traditional Georgist position is that the land tax is ideal because it is a fixed cash payment, like debt service, unaffected by landowner behavior. Thus it exerts maximum incentive leverage, with no disincentive effect.

That is a powerful argument, and probably right on balance. However there is a case for participation which I present here for the sake of comparison and argument.

1. Many private lessees evidently prefer participation, as evidence by share-cropping, royalties, joint ventures, and such arrangements negotiated in private markets.

2. The disincentive effect of share-cropping may be offset in part by limiting the land allowed to any one cropper, as rationalized in the works of Stephen Cheung.

3. A lessor may avoid penalizing capital improvements by letting the lessee deduct them from his rental payments in full at the time of negative cash flow. If they exceed the rental due, he may let them be recouped over time with a stated interest credit. (Here we meet the Averch-Johnson problem, a weakness in this case.) Likewise a taxing agency may let capital improvements be expensed, which is tantamount to exempting their income from taxation.

4. In "pioneer" conditions there may not be enough information to appraise land accurately ex ante, so rent-collection needs to be based on ex post outcomes. "Pioneer" conditions include minerals' exploration in frontier areas, where a great deal of rent will be generated in the near future in Russia. Pioneer conditions also include all private land development in economies where commodity, credit and land markets are underdeveloped.

Conditions of extreme uncertainty are something like pioneer conditions, too. Russia contains vast farm areas of uncertain climate, something like our Great Plains States west of the 100th Meridian (the proposed "Buffalo Commons").

5. Participation, in spite of its frictions and moral hazards, creates more community of interest among the parties, who thrive and suffer together. Resentment against creditors has a long history. Tax collectors who take fixed charges are subject to something of the same animus. The analogy is imperfect because "fixed" land taxes can and should be lowered promptly when exogenous conditions worsen, just as they should be raised when the same improve.

6. Participation helps generate information for tax assessments, as lessees must share information with lessors.

7. With ripening minerals, prog. tax on unripe reserves only collects rent if perfect.

D. A supplemental tax on land gains?

If land rents are 100% socialized, and if the market expects this to continue, there would be no land gains. In practise this is unlikely; some would consider it undesirable: the easiest and generally most accurate way to appraise rent is by monitoring sales of title.

A gains tax is an excellent way of "mopping up" excess rent that the basic rent tax fails to capture. It can be very productive of revenue: in Taiwan the land gains tax captures four times as much as the basic land tax. This is partly because the gains tax is not subject to erosion by lag of assessments behind the market.

I recommend announcing from the start that landowners should expect a high tax rate (80% or more) to be imposed on land gains. It is declared contrary to public policy for land to attain a value based on expected future resale. Possessory interest with emphasis on current use is the desired emphasis.

Resale gains are not to be illegal, but should be continually monitored to audit the system of rent collection. Resale gains are evidence either that basic rent taxes are too low, or there is wide belief they will fall, or fail to rise with rising rents. View this with alarm and aggressively correct it. Experience shows buyers quickly presume they have a vested interest to collect rent based on paying for land titles.

A gains tax can be very high without a serious locked-in effect, when coupled with a high ongoing rent tax. The latter gives strong incentive to dispose of surplus lands. Indeed, the "ripening cost" theorists claim it gives too much incentive. If there is any merit to their rationale, we should favor a greater locked-in effect.

The greatest cause of a locked-in effect with the U.S. capital gains tax is not the tax itself, but the ability to avoid the tax via the step-up of basis at time of death. There should of course be no such provision. Legacies, devises, gifts and other transfers without arm's length consideration should trigger valuation and tax. To avoid discriminating in favor of deathless corporations their lands will need to be periodically appraised and taxed on the gain; alternatively, their shares might be subject to the gains tax.

Land gain shall be defined as the excess of sale price over depreciated cost basis. An administrative problem to solve is the manner of recording depreciable investments and their depreciation, in the (presumed) absence of a general income tax.

A supplemental tax on transfers, based on gross value of lands transferred (not just gain, and not just equity), is desirable as a tool of disclosure, to provide a data base for land assessment.

E. Non-standard resources

1. Exhaustible minerals, ground water, etc. A combination of charges or taxes is recommended, with these components.

a. A flat property taxed based on appraised value of resources in situ.

b. A unit-of-production tax with deduction of all operating costs, and some capital costs.

Minerals' taxation is a most important precedent, because the most aggressive foreign investors introducing market agents into Russia currently are oil companies.

IV. Modifying the credit system

A. Credit follows collateral. With land prices low, owners could not raise much by pledging land for loans.

On the good side, this would end the credit discrimination now prevailing. Today, the basis of credit is not marginal productivity but collateral security. The principles are at odds, and marginal productivity is obviously better from the viewpoing of simple micro efficiency of allocating capital.

Marginal productivity is also better in terms of macro stability. Flows of credit dominated by cycles in the land market are highly unstable. The current S&L calamity should clarify this. It has many precedents, going back at least to the Dutch Tulip Bubble of 1634 and the French-English colonial bubble of 1720. The rule has been that following each collapse the hung-over penitent bankers adopted something like the English Banking School philosophy of avoiding real estate loans and sticking with self-liquidating commercial loans, only to fall off the wagon in the next land boom, repeating the cycle.

In the absence of a land boom, however, they would stay on the wagon. The relevance here is that there have been recurrent periods when the credit system worked very well without major dependence on real estate collateral.

On the bad side, low land prices raise new problems of how to transfer funds to builders and investors. If the system is to thrive, the credit system must adjust massively.

This is not altogether unprecedented or undesirable, as indicated above. There are many particular lenders, even today, who demonstrate the arts of lending without land collateral. Factoring on inventories is a thriving business. Building on leased land is commonplace, with both private and public lessors. Chattel mortgages are common. Even construction loans are secured mainly by capital, not land, because new buildings normally outvalue their land, especially on cheap land. The Reichman Brothers are known for borrowing on the security of signed leases.

To the extent that land taxes displace taxes on capital and wages and transactions, all those become more creditworthy.

B. The problem of public credit

A nation with a sound tax system becomes the most credit-worthy borrower - the collateral is transferred from private to public hands. The matter is even worse with a central bank to underwrite the nation's credit.

In the worst scenario a corrupt, spendthrift administration borrows heavily, paying excessive rates, mortgaging public revenues, and wastes the proceeds. Subsequently, government becomes an oppressive tool of creditors to extract rents from citizens - the 3d World Model. Clearly it is not enough merely to have a good tax system.

To forfend this unintended, perverse outcome some precautions are needed. We cannot say history has not given us ample warning of the threat.

1. No debt shall be incurred without public vote, unless such debt is explicitly not secured by revenues from land taxes.

2. The debt limit shall be 30% of the value of land revenues, capitalized at the prime rate.

3. "Emergency" debt in excess of the limit shall be subject to a property tax whose upper limit is the rate applied to land.

Govt. must be an agency for channeling rents into pub. goods & services, & K formn.

V. Starting up the Market

Russian land is mostly already tenured, held by various government agencies. It is not entirely a matter of surveying and settling wild lands, as in the 19th century U.S.A., (although shifting from communism to a market economy will entail massive changes in land use, and therefore in platting and subdividing land).

The first priority in making a market is pressing those agencies to disgorge their surpluses. The most effective, administrable, non-catastrophic kind of pressure is an annual tax based on value.

Determining value in the absence of a pre-existing market will involve some groping at first. Using the method of taxation lets all groping be limited to one year at a time, or less if desired. Assessed values can and should be adjusted frequently at all times, but especially under pioneer conditions.

Gathering data on value, and assessing land, are mutually supportive activities. That is, applying the tax motivates sellers and causes sales; sales provide data to improve the tax. The unworkability of resource markets with unmotivated sellers is exemplified in much of Latin America, but also in California water resources, which are generally exempt from all property tax liability. Sales hardly ever occur, in spite of the removal of institutional ~~biases~~ barriers, and in spite of extreme differences in marginal productivity accrued over a century of non-transferability.

As indicated in III,C, in some conditions there is a case for preferring participation to fixed cash tax liabilities when a market is getting started. That case must be modified by considering the need to encourage frequent land sales to provide information. In my observation, the selling price of land is generally surprisingly high to anyone who bases his estimates on capitalizing what he has been led to believe is the net rent. That is, the information from sales of title betrays the existence of concealed kinds of net income, either cash or imputed.

The nuts and bolts of transferring land to private tenure involves several steps:

a. Platting and surveying. Units should be small, to accommodate individual bidders. Small units may be consolidated by buyers if they wish; they simply give small bidders an equal chance at the start, cutting out the speculative middleman and providing flexibility.

b. Subdividing. This is a key event that takes capital, allocates land to r.o.w., and permanently stamps settlement patterns. Interactive decision-making is required between (mostly) private on-site and (mostly) public "inter-site" sectors. "Interactive" implies mutual learning and accommodation in a swiftly changing scene. Land taxation

gives the public sector a new, powerful tool to assure optimal private response to public initiatives, e.g. developing private sites accessed by a new transit line or water system. It does not guarantee only wise public initiatives will prevail, but it gives public planners a guide for planning routes: place improvements where they will generate the most rents from the served lands. Place nothing where it will not thus pay for itself.

•. Parcels should be sized to maximize unit value after deducting costs of allocating land to r.o.w. and improving it, and operating/maintaining it over time. Such land planning is now a highly developed art, available to be imported. ut. & infra. access must be available to ea. parcel

←Interactive development planning is a messy, ongoing process one must experience to understand. The somewhat anarchic American process may be too abhorrent to Russian cultural patterns to import whole. Japanese success importing western ideas comes to mind: they did not just import, they Japanized, adapting as they adopted. It is with great nations as Emerson said of great men, they leave no models, each is great in its own way. It would not be surprising if Russia improved on us: there is lots of room for it.

Privatizing land use implies drastically revising infrastructure to accommodate new patterns of use. This will absorb large effort and capital for years to come. The massive Soviet bureaucracy can find a useful transitional, and some permanent role in this huge residual public sector.

Early infrastructure initiatives should be low-cost and as flexible as possible, with little thought of building for the ages. Experience must be gained with private sites.

VI. Precedents

A. The Province of British Columbia owns 95% of its own land area. That is not the best urban land, generally, and much less than 95% of its land value, but still a vast empire. This land is leased to private parties for logging, power generation, mining, "water lots," and other varied private activities, which supply much of Provincial revenues (and could supply much more if better administered).

B. The Province of Alberta owns some 90% of its subsurface mineral wealth, which it leases to private parties under a sophisticated system calculated to encourage competition, enhance the value of reserved lands, and maximize Provincial Revenues. Through careful administration and husbanding this Province has grown fabulously rich, and would be richer yet had not its success, coupled with low voting power in Ottawa, inspired successive Federal raids on its revenues (analogous to, but less bloody, than Saddam Hussein's Anschluss with Kuwait).

C. The State of Alaska owns, like other coastal states, a 3-mile strip of what are now called "tidelands." Prudhoe Bay is located there. By tapping this rent, using various

tax methods to compensate for a fatuous leasing policy, Alaska has contrived to eliminate most other taxes.

They set about declaring a social dividend, an efficient and equitable method of distrition, but were unfortunately stopped by the USSC decision in Zobel v. Williams. The bad news is they have subsequently dissipated their rents in riotous spendthriftiness now driven by a concept of "regional equity," also known as logrolling and porkbarreling.

D. The U.S. Government administering the OCS under the BLM sets a worse precedent. It provides generous tax subsidies for the industry, then leases land at low royalty rates, with the bonus bid up front as the bid variable. The results are to discourage competition, encourage preemption, etc.

E. ~~Mos~~ Hist. of Eur. settlement in W. Hemisph. & Antipodes is a storehouse of love on purge. public lands.

VII. Implications for U.S. domestic policy

Idea - For Social Collection of Rent.

I, A 1. Govt. owns it. (/+ also owns K)

a. Why not cash in up front.

~~1.~~ Fire-sale prices.

~~2.~~ Mis alloca. results.

~~3.~~ Gov. needs perpet. revs. Other rev. ~~3.~~ sources suppress produ., depress K formn., distort alloca., cause rent-seeking to control p.w. ~~4.~~ Local gov. also needs revs.

~~5.~~ Can tax land now held by govt. agencies.

6. Can untax land w. open access; r.o.w.

(1) ~~5.~~ #1 priority is pay surplus land home from govt. agencies. Not starting w. clean slate.

~~E.O~~ 2. Idea is not to recreate S.U. in our own image. Synthesis of our good ideas + theirs.

We have problems, too.

I, A 3. Moral.

Once land becms pvt., unearned inc. begins.

~~4.~~ Use of royalties for ~~ecth~~ exh. revs.

~~5.~~ Use of land gains tax.

6. Adapting credit system.
   Chattel mortgages
   Psnl. credit
   Factoring
   Bldg. on leased land

~~7. B.C. as precedent.~~

~~8. OTS as precedent.~~ Also other Fed. lands.

~~9. Mining comes first.~~

10. ~~Leasing works poorly, clearances too much foresight, usually collects too little.~~

11. ~~Land~~ Taxn. ~~makes mkt.~~ develop fast.

12. Tax rent of rich areas, distrib. per cap.
   Not to have-not regions. Nations shd. be ready to abandon surplus lands.

13. Combine Kst effic. w. socialist egalitarianism.
   Psnl. init. is the irreplaceable motive power of prodn & progress, but

must be taxed. "Earnings, findings + stealings"

14. Why land is different.

15. Rent as resid = rent as MP

16. U.S. model, 18th - 19th cents.
    a. Territ. Govt; Fed. troops.
    b. Sovereignty to Territ., then states
    c. Cities, mille time taxs reigneum.
    d. No aid - local govt. self suffic.
    e. [No deleg. of pwr. to tax except land, but l.v.)

17. Harness Δ l.v. to build infra.
    "K for this RR lies sleeping in the land."

18. There may already be some exchanging of land among agencies.

19. Nuts + bolts.
    Surveying
    Platting. (dividing, gridding)
    Subdividing — roads, streets, + s.i. — "intensive" sector, major part of infrastructure. Access edges.

20. Infrastr. is my subord. topic – to help land mkt. go.

21. How to make a land mkt. (Freq. sales is key)
~~Fee~~ titles, subject to known servitudes, incl, tax
~~Rent~~ Pub. holdings taxed.
~~Tax~~ ~~Act~~ [Initial auction of lands of ^ against which are closed ~~agencies~~]
Every agency required to offer 5% of its land for sale. Asking price is basis for valuing the whole, until sells.

22. Annual revaluation ^ of land is key, whether of rent or value.
a. Based on comparables.
b. Based on showing. Poses incentive problem, but keeps current, automatically, which makes up for the other failings.
~~c. Gains tax.~~

23. Prohibition on taxing: ~~its~~
Wage & salaries
Commodities

Forces recourse to land by whatever method.

24. Adequacy: Physiocratic

25. Utility rate structures
Flat rate based on value of service ≡ value of land served.

26. Squatters – they wd. be hard to evict, ~~but~~ en masse. But can be required to pay tax, non-payors evicted selectively.

27. Joint ventures, U.S. firms w. Soviet "Ministry of (the) Oil & Gas Indy."

28. K:O ratio ≅ 3
Meaning mean K has life of 3 yrs.
∴ can be sold, not leased, easy fnc'g problem. Is also self-liq.

29. Privatizing
There is a shadow ec. w. some millionaires.
Precedent in Eng.
But here, we are privtg where there is no priv. sector. Alien ownership resented. No gov. nation can afford to have most of its land owned by aliens. Rent collection gives power. rent collected

30. Another bad experience w. leasing: J. Nat. Fund + J. Agency in Israel. 50-yr. leases, fixed rents.

31. Dorfman wants more on varieties of land tenure.

32. Implicns. for west bloc.

33. Pentico.

34. Coops: Ejido, Kibbutz, Mir

35. Upstream, downstream.

Upstream, few raw mtls are bought. Rent is gross rev. less opg. cost less K × c+f. All gross is value-added.

Downstream, most raw mtls bought. Value-added is small share of gross. But rent may still be hi share of v-a.

36. If state enterprise sells or leases assets to priv. individ:

a). Who gets to keep the M? This is not really ~~liquidating~~ liquidating the state enterprise.

b.) Who will replace the K that is leased out? Stnd. sell K: "lease" land.

37. Alt. ways to collect rent: pros + cons.

PRELIMINARY, 9 February 1990

On revising land tenure in nations emerging from communism

Mason Gaffney

1. Some private enterprises with apparent land tenures already exist in USSR.

McDonald's fast foods
Reichman's proposed 60-story building (are they to own it, or just construct it for some state agency?)
Ventures of Armand Hammer?

Agenda: study these tenures.

2. Most land is already tenured, i.e. not a commons. We must work from the existing system. Presumably land is assigned with more or less formality to the state agency that operates or administers it. Possibly some transfers have occurred among agencies; possibly even some rents are paid. We must overcome our knowledge vacuum.

Agenda: enlist a sympathetic Soviet specialist with an interest in land tenure.

3. Transferring land to private control involves several steps.

a. Platting and surveying. Platted units should be small, to accommodate individual bidders. Existing bias for gigantic scale must be acknowledged and drastically offset -- their idea of "small" may be 1,000 acres or so.

Small units do not put upper limit on size of holding. Initial bidding should let bidders go for more than one parcel at a time if desired. Small units simply mean small bidders have an equal chance; they provide flexibility. They also point toward a primary state role in platting and subdividing (infra). (If units sold are above optimal scale, then the first private buyer is in charge of platting and subdividing.)

"State" is used generically to include regional and local government, without specifying the level at this time.

b. Platting is on paper; subdividing is in the field. Subdividing takes capital and permanently influences settlement patterns. It is a key event that dominates layout of the public sector. It entails provision of networks of streets and street improvements, by allocating rights of way, and points or edges of access of private land to public ways.

Interactive coordination and decision-making is required between (mostly) private on-site and (mostly) public "inter-site" (street, road) sectors. "Interactive" implies mutual learning and accommodation among autonomous public and private parties. LVT gives the public sector a new and powerful tool to elicit and assure early optimal response of private sector to public initiatives -- e.g. filling in private sites accessed by a new road system, or mass transit line. It does not assure the wisest public initiatives will prevail, but also gives the public sector a guide for planning roads and transit: route them to area that will generate the most public revenue from higher land rents. (Enclosed paper, "Land Planning and the Property Tax," makes a start.)

More than routing is involved. Sizing parcels is a key decision. General rule is to size parcels so as to maximize unit value after deducting costs of allocating land to r.o.w., and improving it, and operating/maintaining it. Platting, planning and subdividing are highly developed arts, available to be studied and imported (and modified as desired).

We can show them general guidelines. Implementing the concept of interactive development planning may require major reorientation of embedded Soviet and Russian cultural patterns. It is an ongoing, messy process one has to experience. The Russian experience has been and will continue to be different.

[It is probably fortunate we are not in a position to offer our own culture as ideal, a posture likely to provoke resentment. Rather ours is a churning stewpot of experiments from which they may learn, from failures as well as successes.

In their present mood of contrition and eagerness to learn and change, coupled with their authoritarian background, they may actually respond best to attitudes we would normally reject as arrogant. The Japanese attitude toward McArthur's reforms comes to mind. We must get to know them, test their reactions, and meet their psychic as well as intellectual needs. Japanese success, however, entailed absorbing and Japanizing western ideas, not imitating slavishly; not from adopting but adapting. It is with nations as Emerson said of individuals: Great men leave no models; each is great in his own way. The Russians will do it their way; we must expect that.]

Providing good intersite infrastructure fosters small scale private firms on sites. Intersite improvements are roughly coterminous with "public" sector (including regulated private sector). The massive Soviet bureaucracy can find a useful transitional role, and some permanent work, in this large residual public sector.

Privatizing land use implies drastically revising the

public intersite sector to accommodate the new patterns of use. This will absorb large effort and capital for years.

Parts of the public sector must lead, as land is divided. Early improvements should be low-cost and as flexible as possible, while experience is gained with the private sites. The optimal size of firm, and intensity of land use, depend in part on what public sector does.

c. Recording titles and deeds. (A Torrens System is probably best, but not a major issue.) All records shall be open to public inspection. (To reenforce and dramatize the point, data on land shall be publicized pro-actively, not as a grudging concession to some persistent reformer-researcher.) No unrecorded contract shall be enforceable.

This is occasion to record public servitudes, announcing the prior public claim on ground rent overtly, unmistakably, unambigously. Repetition and redundancy are permissible and desirable: unrepeated laws easily lapse into dead-letters.

All debts secured by capital affixed to land shall be recorded (otherwise not enforceable). Every recording shall explicitly acknowledge the private debt is subordinate to the public right to ground rent. Land itself shall never be pledged by private parties. Neither shall the state pledge land to secure its debts.[1]

All title transfers (deeds) shall be recorded, and the consideration. Details shall immediately be posted publicly, in a form easily understood by normal literate adults. (A Bureau of Land Statistics shall be formed to publish and analyze this data on an ongoing basis.) Payments shall be made only in cash, through a public escrow (or audited private escrow). Penalty for violation is forfeiture. This penalty shall be mandatory, not at judicial or administrative discretion.

d. Bidding. Initial sale of titles is by competitive bidding. Terms of sale are these.

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[1]The reasoning is that this opens the possibility a prodigal administration might indirectly alienate the nation's land by overissuing debt. The state would then become an instrument for collecting rents for the benefit of bondholders. The history of public debts offers ample warning.

The idea, rather, is the state shall be an instrument for channeling rents into public goods and services, and capital formation.

i. The standard term is a stipulated initial ground rent, cash, due at beginning of each month. All other interests in land are subordinate to this rent, as well as to later increments as determined below.

(Non-standard terms shall be developed, a) for special situations like water rights and mineral exploration; b) for extra-risky lands where operators show a strong preference for forms of participation; c) for pioneer conditions where deferring part of rent may be justified.)

ii. Annual revaluation of cash ground rent, based on comparables, records of net proceeds, and other evidence in standard use by valuers.

I will use the term "rentax" to identify this charge. It may take the form of a rent or a tax, depending on the kind of tenure. Presumably there will be both leasing (what we call non-freehold tenures) with payment of rent; and transfer of fee simple title (what we call freehold tenure) subject to tax.

[Less frequent revaluation, say quadrennial, will be suggested, allegedly because of expense. This argument strains at a gnat and swallows a camel, and should not be accepted. If it is, however, revaluation should include lump-sum recoupment of rents over prior three years, if comparables indicate it is warranted. Be strict about this, to avoid any impression the state's claim is secondary. Experience shows landholders quickly adapt to low rent-taxes, regarding them as vested rights, and ungratefully resist increases, let alone repaying past favors.]

iii. Landowners are put on early notice to expect a high tax (something like 80% or more) on gains, if any, from sale of land with fixed capital. It is declared contrary to public policy for land to attain a value based on expected future resale. Resale gains are not illegal, but should be carefully monitored as an audit of the system. Existence of resale gains is to be taken as evidence either that cash rentaxes are too low, or there is inadequate public conviction they will continue to take all the rent, and/or adjust upwards with rising rents. This is to be viewed with alarm and aggressively corrected, knowing how quickly buyers presume they have a vested interest in private rent-collection based on paying for land titles.

A very high gains tax will have no damaging locked-in effect; the annual rentax liability is a strong ongoing incentive to dispose of surplus land.

Gain is excess of sale price over depreciated base.

Agenda: Determine manner of recording fixed

investments, and depreciation, in presumed absence of income tax. A tax on "net proceeds" (land income), conjunctively coordinated with a fixed cash rent-tax, is a possibility to be thought out and/or researched before our meeting.

Transfers without arm's-length consideration at time of death, or other legacies, gifts and bequests, shall trigger a valuation, with tax on the gain if any. [Organizations depending on bequests will object. The answer is, it is desirable they be supported by donations from sources other than land, so they will be inclined to cater to the entire society, being less dependent on rents.]

Agenda: Coordinate this with treatment of deathless corporate owners, to avoid bias against non-corporate owners. USSR will be in process of facing the entire question of corporations and their status.

A supplemental transfer tax, based on gross value of land transferred (not just equity), may be desirable as a tool of disclosure.

iv. Possible net proceeds tax, conjunctive with fixed cash rentax. This is to accommodate the preference for participation shown by some lessees and taxpayers.

A net proceeds tax would be graduated according to return on real capital placed on site. It is based on the idea of participation, sharing risks and gains. Some lessees seem to prefer this to fixed cash payments. This tax will vary inversely with quantity of capital placed on site, and directly with rate of return. This is the most contestable and complex proposal, and is to be justified (or rejected) and detailed in Appendix.

(Appendix to present draft only itemizes some major issues and considerations. It does not present a workable, affirmative proposal. That remains a priority agenda item to be completed in writing before our meeting.)

v. Ceiling price. Up-front price shall be the bid variable only up to some modest ceiling. The objective is <u>not</u> to collect for land up-front, but over time, in perpetuity.

Persons wanting to bid more than the ceiling price shall bid by raising the ground-rent offered. (Alternatively, they might bid by offering a higher share of net proceeds.)

vi. Land users shall be subject to police power as to nuisances, etc.; to eminent domain; and other standard servitudes.

vii. Books of owners and lessees shall be open to

inspection by assessors, as basis for determining rents or net proceeds.

viii. No public employee may accept employment with a private person whose property he has valued, nor own or lease land other than for a primary residence and one vacation home.

4. Education and training of valuers shall be given highest priority.

APPENDIX

Net proceeds tax

1. Announced objective is to secure for state the ground rent of land, and secure for lessee or landowner a return for his capital and labor applied to land. All measures are to be interpreted and administered subordinate to that overriding objective.

2. Advantages of cash rentax

a. Precludes stalling, the most common fault of landowners. Owner-tenant pays for right to exclude others from the land, which is what "using" or "consuming" land actually entails in essence.

b. Subordinates other claims.

c. Inhibits engrossment and forestalling.

d. Has no marginal disincentive effects on land use -- only on preemptive landholding. (Can be shown to have a positive marginal incentive on usufructuary landholding.)

e. Requires the least record-keeping.

3. Disadvantages of same

a. Puts all (uninsurable) risk on owner-tenant: risks of product price decline, of weather, of input cost, of obsolescence of capital, of inappropriate capital improvement, etc. Adds a special, novel risk, that of overassessment of land following commitment of fixed capital. Soviet tradition of arbitrary abusive authority, and confiscation of capital, may exaggerate the disincentive effect of this anxiety.

b. Lenders will be nervous, too. They are used to using equity in land as collateral cushion, when they finance new buildings. That is not a desirable or necessary condition, but

they need some weaning away from it. We are talking about a revolution in financial practise when we devalue land as collateral. Lenders will resist it: it makes them work harder, evaluating projects and individuals rather than just appraising land.

Agenda: gather elements of record of experience of lenders in Irvine area, Hawaii, federal lands, Canadian crown lands, other areas where land is owned separately from buildings. Reichman practise is instructive: they pledge leases for loans, rather than title to real estate. Factors are skilled at lending on inventories without land security.

c. Penalizes or taxes owner for finding new virtues in land: a new higher use, minerals, etc.

d. In pioneer conditions presumes advance knowledge that is lacking: knowledge of qualities of land (especially subsurface minerals); of land market; of demand and supply conditions in markets that may not yet exist.

e. Generates no information, as income tax does -- assessor does not see the books routinely.

f. May result in lower returns to state, if land users prefer risk-sharing participation and will pay more (averaged) under participation. The evidence that users may pay more is that in private markets participative leases are common. This phenomenon warrants careful study.

Agenda. I shall provide a firm proposal for an optimal participative lease, or net proceeds tax. I started to write this but got bogged down with that feeling (which you know too) there is a nut to crack, after which a proposal will fall together. I will crack the nut first, before imposing my scattered thoughts on you.

I am not at this time fully persuaded the net proceeds idea is worth endorsing, except in limited applications like exploration for minerals. Do not interpret my interest as advocacy or conviction. I may go either way; I have some thinking to do. However it is important we do that thinking, so we can explain why we reject it (if we do). It will surely come up.

Enclosures:

Land Planning and the Property Tax
Objectives of Government Policy in Leasing Mineral Lands

25 September 1990

Mason Gaffney
340 Tyler Street
Riverside, California 92503

Dear Mason:

Nic and I thoroughly enjoyed discussing your paper. Indeed, it reminds him of Samuelson's Foundations: "gemlike and sparkly" and ever so concise.

On a rather ratty copy, I convey some editorial suggestions from both that talk and another pass I gave your work yesterday while also enjoying the brisk air and clean sunlight of a New England fall at the serene setting of the (public) Urban Forestry. They are just suggestions; it's your paper, and we quite like how you alternate long and short sentences: the style both reflects and reinforces the punch of the substance. Nonetheless, I've tried to make the headings parallel and the "data"'s plural and to address the sensitivity of the various Soviet people to the terms "Russian" and "Communist". Because of the topic of the conference, both Nic and I favor never writing your to-be-written last section on implications for U.S. policy, replacing it instead with a summing up of sorts. Nic thought perhaps most of the first section should also be cut, but I think it takes away any edge of superiority someone making suggestions might otherwise convey.

This project has been great fun so far, and I'm learning a lot from both the papers and Nic's incisive commentary. I hope your fall is also a good one, and look forward to hearing from you.

Sincerely,

Adele

Adele Wick