



Some Economic Aspects of Land-Use Regulation

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FACTORS IN THE FARMLAND MARKET

Report of a Land-
Market Seminar
Sponsored by the
North Central Land
Economics Research
Committee



Discussion: Gaffney

I wish to record a generally favorable response to Professor Pendleton's interesting discussion, and this despite his statement that rural land economists are "much more capable people" than urban ones. His statement might be more correct in respect to quantity rather than quality of effort in the two fields, thanks to the workings of the Morrill Act. When we consider how greatly urban real estate outvalues rural, the unbalance is glaring indeed.

I applaud Pendleton's beginning with a perfect market as a norm. A perfect market may be an imperfect base of reference, but it is a wonderful improvement over some of the alternatives I have witnessed. I might cite the Southeastern Wisconsin Regional Planning Commission, which is engaged in planning the future of our region for the next 200 years without benefit of any economist, as an example. It is developing as a norm what might be characterized as a "technocratic" settlement pattern. Location is to be determined by site qualities, which the engineers understand, with minimal reference to location, whose importance rings strangely in their ears. They project land "requirements," a coefficient which is not affected by price. They lay their plans giving first priority to uses of the lowest density, leaving the leftovers for commerce and other profane uses.

These are failings that economists have learned to associate with technocrats who see only pieces of the full spectrum of location factors and reject with some vigor other values which they do not understand. The market with all its faults is automatically broad-minded—it balances large numbers of locational factors and forces on our unwilling attention points which our specialized and preconditioned minds overlook.

I also applaud Pendleton's use of the net increment to land rent as the basic measure of net benefits from public works. Most welfare economists and many benefit-cost analysts have been too slow and obtuse about seeing this elemental truth.

Third, I applaud Pendleton's clear distinction between rent increases that reflect social gains and others that reflect merely redistribution.

On the negative side, I believe Professor Pendleton understates how much we need to modify the basic norm of the market. His paper might have been more interesting if it had led us further into such new fields. The idea that the market should be held innocent until proved guilty is

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carrying things too far. The market is already proved guilty by the mess and sprawl surrounding our cities as well as by the rotting of their cores. Secondly, land values are a public product in their very inception, the result of public works, street and highway layout, etc. They are an area of joint public and private determination and can never be treated wholly as one or the other.

I also think that Professor Pendleton has overstated his analogy between rural zoning and urban zoning. These two types of zoning have in common the purpose of segregating land uses. But the historical purpose of rural zoning, at least in the midwestern cutover states, was to reduce public costs by increasing the density of population settled on the land. Shortening the public roads that served as private driveways for nesters and squatters way back in the north woods was a primary concern. Urban zoning, on the other hand, is primarily geared to reducing the density of population on the land. At least this is the form in which urban zoning has evolved in the 1960's.

Let me suggest a few new research fields which Professor Pendleton's paper might have developed:

1. *Distributive equity.* This problem was passed over too lightly. I have never been able to accept the sharp division of distribution from production theory that characterizes much of modern welfare economics. I cannot accept the idea that social welfare is enhanced when someone gets something for nothing. It is a sterile philosophy which only asks what we get and not how we get it.

The idea that distribution and production belong in separate compartments is inconsistent with the entire market mechanism idea which we have postulated. The market mechanism requires a close correspondence between contributions to production and the division of the product. Income is the incentive to produce. If certain favored landowners get something for nothing, it follows inexorably that other taxpayers are getting nothing for something. That in turn is almost certain to distort resource allocation.

2. *Traversal value of flood plains.* Transportation through the flood plain which is of benefit to lands outside the flood plain would also show up in the value of the flood plain. For example, one of the great benefits of flood control in Milwaukee, which is bisected by the Menomonee Valley, is facilitation of traversal of the plain. This ties the city together, increases the scale of the market, reduces the cost of linkages among economic units, etc. The traversal value of flood plains is also important because such plains frequently have excellent central locations.

3. *Secondary benefits.* The benefits of flood-plain reclamation are reflected in the value of nearby lands which may constitute part of the trade territory. I recall the furor with which the Kaysinger Dam project on the Osage River was greeted by the city officials of Clinton, Missouri. The dam was to have flooded out part of their trade territory and they were acutely aware of the potential loss of property values. On the other hand, if the Kaysinger Dam was to protect any downstream plains from flooding (a point which was by no means certain), the benefits would be felt not just on lands protected physically, but also on neighboring lands linked to the flood plain by bonds of trade.

4. *Fiscal benefits.* The increase of land values is only a partial measure of the benefits from land reclamation because it is capitalized from that part of the total benefits which is to be privately received. In our world of high tax rates as much as half of the equity may belong to the Treasury and be expressed in the form of higher tax revenues. Indeed, this is a primary force behind urban renewal at the present time. Professor Otto Davis has pointed out that the rational municipality should, up to some optimal point, subsidize land clearance and redevelopment in order to increase its tax income. Whitefish Bay, Wisconsin and two or three adjacent communities are already doing exactly this. Shades of Kameralism!

To get a true picture of the situation we should not only count the increased taxes, but should also deduct the increase of public costs, if any, necessitated by a project we are evaluating. We should also deduct the reduction of taxes elsewhere, if any, and credit our project with a decline of public costs elsewhere, etc., to eventuate with a grand net fiscal effect. How far we carry this depends on how perfect a job we want to take the time to do and how high a unit of government we are working with.

5. *Maximization of private and fiscal benefits through intelligent fiscal policy.* The fiscal benefits just discussed may not be taken for granted, either as to quantity or timing. A neglected area of study, one in which research would pay big dividends, is the shaping of tax policy with a view to accelerating and maximizing benefits, both public and private. Our usual procedure has been to invest a great deal of public money in works projects that enhance the productive capabilities of benefited lands and then to defer the resultant tax benefits from private lands by making the taxes contingent on the improvement and use of these lands. Under the general property tax, for example, we tax primarily new buildings, and our tax increment is deferred until buildings are built. The buildings in turn tend to be deferred to defer the taxes.

Professor Pendleton suggests that the potential economic rent of benefited lands is a measure of social benefits. With that I must disagree because this potential is usually not realized for many years, and, to paraphrase the Supreme Court, benefits deferred are benefits denied. The deferral of public benefits is not counterbalanced by an equal and opposite increase of private benefits because the privately collected rent from which land values are capitalized is also deferred and depressed because the landowner can not earn income without increasing tax liabilities. The result is that the sum of private and fiscal benefits is below capacity and behind schedule.

An alternative tax procedure, of which I am a partisan, is to levy real estate taxes on the basis of the enhanced income-yielding capability of the land. Then the fiscal benefit would begin as soon as the public works are completed. Private benefits would also begin sooner because of the pressure to improve private land immediately. By closely synchronizing public works and private investments, waste would be avoided and in this way I think we really would be getting something for nothing. An additional advantage would be the maximizing of spillover benefits that one landowner's improvements render to his neighbors. A further benefit, which has political overtones, is that this method of taxation would serve nicely to temper the competition for public subsidies by regional interests in our city councils, county boards, state legislatures, and Congress. The introduction of a sobering element of rationality into the log-rolling process would be a welcome change from modern practice.

In conclusion, I suggest that Professor Pendleton's subject raises a larger question — why do people insist on settling on flood plains anyway — which needs attention. And even more generally, why do people insist on occupying submarginal lands, lands which require large public investments to fit them for permanent habitation, when the simple pressure of population on resources has not as yet made that necessary. What is wrong with the market mechanism or the political mechanism that these lands of higher natural capabilities are not occupied first?

In terms of policy, I suggest that we are fighting a losing battle if we emphasize the negative, fencing people off the flood plains. We can fight a winning battle by positively encouraging the intensive development and improvement of lands which nature has already better suited for human habitation.