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THE TAXATION OF NATURAL RESOURCES AND THE FUTURE OF THE RUSSIAN FEDERATION*

CHARLES E. MCLURE, JR.
Hoover Institution
Stanford University

INTRODUCTION

The vertical and horizontal division of revenues from the taxation of natural resources among Russian governments is crucial to the future of the Russian Federation. The geographic concentration of resources is such that allocation of revenues primarily to the jurisdictions where production occurs would create enormous fiscal disparities among subnational governments. These disparities could threaten the viability of the Federation.

The concentration of oil production gives an idea of the nature of the problem. The Siberian oblast of Tyumen contains only 2 percent of the population of Russia, but produces almost 65 percent of its oil. The autonomous okrug of Khanti Mansisk, in turn, contains less than half of Tyumen's population (about 1 percent of the population of Russia), but produces virtually all its oil. Depending on whether one focuses on the oblast or okrug level, oil production in Tyumen and Khanti Mansisk is either 30 times or 70 times as concentrated as population. Russia has historically been the world's largest producer of crude oil. Though production has plummeted in recent years, if the okrug, or even the oblast, were to receive most of the revenues from taxes on oil, enormous horizontal fiscal disparities would result.

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*This paper is based on McLure (1992), which contains further references to the literature. The author wishes to thank Christine Wallich for her invaluable assistance.

Because of Russia's rapid inflation and falling oil production, it is difficult to relate potential resource revenues of subnational governments to other economic variables. Under existing law, Tyumen (including Khanti Mansisk and local governments) receives 80 percent of an 8 percent production tax. Even at the controlled domestic price of oil prevailing in July 1992, this would have amounted to per capita revenues in excess of 80 percent of the minimum wage prevailing at the time. At world prices Tyumen would receive revenues of almost five times the minimum wage. If Khanti Mansisk were a separate okrug--which it has significant economic incentives to become--per capita revenues would be 160 percent of the minimum wage at the controlled price and almost 10 times the minimum wage at world prices.

To provide some international perspective it is worth noting that Alaska has roughly 0.2 percent of the population of the United States and produces about one-fifth of the nation's oil; the comparable figures for Alberta and Canada are 7 percent and 85 percent; thus ratios of production shares to population shares are about 100 in Alaska and 12 in Alberta.[1] During the energy crisis of the late 1970s and early 1980s the resulting fiscal disparities created talk of "blue-eyed Arabs" in both countries and of a "new war between the states" in the United States; in Canada there was some talk of secession by the western provinces. Whereas those controversies occurred in the context of established federal systems that could survive the jealousy and acrimony, the situation in Russia is quite different. There the political situation is

very much in flux and federation is weak. Moreover, some oil producing areas (e.g., Tatarstan) have large non-Russian populations which for ethnic reasons may prefer not to be part of the Russian Federation.

The next section reviews traditional thinking on "tax assignment" to determine what it has to say about the optimal intergovernmental division of revenues from natural resources. The third section notes that during the transition to a market economy in Russia there are more potential claimants to resource rents than in a typical Western society.[2] If these claims are effected, there may be little resource rents to tax. Finally, if a few jurisdictions are able to appropriate a large fraction of public revenues from natural resources, or if small groups of people are able to capture a large portion of resource rents, they will face an important question: what to do with the money. This is the subject of the fourth section.

THE TAX ASSIGNMENT PROBLEM

There are strong conceptual reasons to assign most revenues from resource taxation to the central government.[3] First, resource rents may fluctuate more than the bases of most other resource taxes, because of movements in world prices of resources. Central governments are better able than subnational governments to absorb and offset fluctuations in revenues. This consideration is less applicable to other forms of resource taxation, such as property taxation based on the values of resource reserves.

Second, extreme concentration of tax revenues at the subnational level may result in inefficient economic behavior. (See Flatters, Henderson, and Mieszkowski, 1974; McLure, 1984; Mieszkowski, 1983; and Mieszkowski and Toder, 1983.) Such inefficiencies may take several forms. Non-resource taxes may be reduced to the point that the jurisdiction becomes overly attractive as a place to live or to invest. In the extreme case non-resource taxes may be reduced to negative levels, as when Alaska paid annual dividends to its residents following its oil bonanza. Even if non-resource taxes are not reduced, subnational governments may expand public expenditures to the point that the jurisdiction becomes artificially attractive. In either event, labor and capital that could be employed more productively elsewhere come to the state purely for tax reasons or to enjoy the benefits of cheap public services.[4] Subnational governments may also have a tendency to spend seemingly plentiful resource revenues in ways that are less productive than outlays foregone by governments not blessed with resource revenues.

Third, many probably would find it unfair that residents of some parts of a nation pay markedly lower taxes or enjoy substantially higher levels of public spending than others, simply because of where they live. This suggests that resource revenues should flow to the central government, not to subnational ones.

This equity argument for centralized taxation of natural resources calls into question the very nature of federalism. The issue can be summarized simply: who are "we" and who are "they?"

If "we" see ourselves primarily as citizens of the United States (or Canada or Russia), rather than as citizens of particular states (or provinces or oblasts), assignment of revenues from natural resources primarily to the central government presumably makes most sense. If, however, our primary identification is with the subnational jurisdiction, primary assignment of resource revenues to subnational governments is more appealing.

This question--the "domain of concern"-- is also relevant for the question of economic efficiency discussed earlier. We feel outrage when "our" money is wasted, but may not care very much when "they" waste theirs. Moreover, we usually feel little concern--or at least seldom act upon our concern--if economic resources are attracted artificially to an oil-rich country that has low non-resource taxes or high levels of public spending; after all, it is another country, and we have no right to share in their wealth or to tell them what to do with it.[5] The question at hand is whether the domain of concern about the efficient use of resource revenues, as well as for the definition of equity, is the nation or the subnational jurisdiction.

Advocates of states' rights to resource revenues often trumpet what might be called the "inheritance" or "entitlement" view; see, for example, Link (1978). They argue that the resources are the inheritance of the state, which is entitled to tax them. This reasoning is circular and begs the basic question. If the domain of concern is national, then presumably the natural resources are the inheritance of the entire nation, and states where resources

happen to be located have no unique or prior right to revenues from them. Only if the domain of concern is subnational is the inheritance argument for subnational taxation convincing.[6]

In the Russian case economic arguments may be largely academic and irrelevant, given political reality; the Federation may not survive--or may survive only if the central government uses coercion--if subnational governments are not allowed a substantial share of revenues from the exploitation of natural resources located within their borders. But the Federation may not break up quickly, because some resource-rich regions are so dependent on the center that they could not soon afford to leave the Federation.

NON-GOVERNMENTAL CLAIMANTS TO RESOURCE RENTS

The discussion to this point implicitly assumes a relatively stable economic and political environment. This is in marked contrast to the actual situation in Russia. Because the Russian economy is in transition, many groups are attempting to appropriate the potential base of resource taxes. Before describing the situation in Russia, it is worthwhile to digress to consider its recent Western analog.

The Arab oil embargo upset the status quo. It precipitated the energy crisis, raised prices, and created enormous potential profits in the oil industry. Oil-producing jurisdictions took a large share of the potential profits in the form of taxes and royalties, and some raised their taxes on natural resources in the effort to increase their shares. Consumers, via price controls

enacted by both state and federal governments, attempted to prevent the profits from materializing, and thereby appropriate part of the potential rents. Consumer states also laid claim to oil profits, for example, via worldwide unitary taxation.[7]

Consider now what has been happening in Russia. First, consumers benefit from controlled prices--so much so that it is unlikely that there are any profits in the oil sector.[8] This need not keep others from trying to get a share of non-existent profits--or at least position themselves to do so when domestic prices are liberalized.

Workers and managers in the oil sector are trying to grab some of the profits. The techniques and likelihood of success exceed those in the West. First, where there is state ownership, managerial incentives are weak, and managers may prefer to pay higher wages than to risk confrontation and strikes. This is especially the case where "labor management" exists. Managers who retain their jobs at the discretion of workers are not likely to resist strongly paying higher wages with someone else's money.

Nor is the government likely to weigh in heavily on the side of management in the case of labor unrest in the resource sector. Workers in these industries can bring the country to its knees, either because they produce energy that is needed at home or because their products are sold abroad for foreign exchange.[9] Even after substantial privatization occurs, the situation may not look much like that in the West. That depends in part on the labor laws adopted in the meantime.

Privatization and the liberalization of prohibitions against foreign ownership add to the puzzle. Workers and managers in the resource sector benefit at the expense of governments if they can gain ownership of the enterprises that employ them on favorable terms. Foreign firms are also seeking attractive terms in contracts to exploit natural resources. This is not qualitatively different from the situation in the West, but the stakes are much higher, as is the uncertainty surrounding foreign investment. What in retrospect may look like enormous rents 10 or 20 years from now may be necessary ex ante to justify investment.

Customers and suppliers of the resource industry, and by extension their workers, managers, and potential owners, can also be expected to try to capture some of the resource rents. For example, Ukrainian firms may no longer supply oil field equipment unless they are paid world prices. Domestic industry is highly concentrated in a few firms. Some suppliers may be able to demand monopoly prices. International competition will limit this in some cases, because oil firms will be able to earn the foreign exchange needed to import modern oil-field technology. Other suppliers and pipeline enterprises will try to set high rates. These enterprises will probably eventually come under regulatory control and anti-monopoly legislation resembling that in the West. There is no way to predict whether they will gain larger shares in resource rents than their Western counterparts.

There have been persistent rumors that individuals are making enormous profits by illegally obtaining licenses to buy oil at the

domestic price and sell it on the world market. This claim on rents has little counterpart in developed countries in the West.

Of the 1.3 million people living in Khanti Mansisk, 54,000, or 4 percent, are indigenous persons, many of whom have a traditional life-style based on hunting, fishing, and the herding of reindeer. Under the Soviet system these people lived in abysmal poverty; neither they nor the subnational governments where they live benefitted appreciably from the region's oil wealth. This may change dramatically. Legislation before the Supreme Soviet would effectively give these native peoples veto power over development of resources on their native lands. (President Yeltsin has already signed a decree doing this.) Depending on the constraints placed on the exercise of this power--and the skill with which the power is exercised, the Khantis and the Mansis could appropriate much of the resource rents in question and become very wealthy.[10] It is likely that much of this wealth would be taxed away.

USE OF GOVERNMENT FUNDS

If the subnational governments of resource-rich regions or the native peoples living there are successful in appropriating a sizeable portion of resource rents, they will face a question faced by many others, many of whom have not answered it well: what to do with the money. Their natural inclinations, to invest locally in the interest of economic development and perhaps to pay dividends to the local population are not necessarily the best ones.

In the short run most revenues from natural resources realized by subnational governments may be used to augment public spending, including the payment of pensions. This may be appropriate, given the low levels of living standards, especially among the elderly. Dividends would relieve the poverty in which the local population now lives. But large dividends could destroy the self-reliance of the recipients. If native people become wealthy, the risk to their traditional way of life is especially great.

The state of Alaska and some foreign countries have responded by investing oil money where they could obtain the highest return. Others, especially in less developed countries, have followed a strategy of resource-based investment; that is, they have invested in down-stream processing of their resources, in order to provide jobs, with little regard for the economic rationality of such a strategy. (Most down-stream industries are extremely capital intensive. Thus they are not likely to be the most appropriate for a labor-surplus economy interested in creating jobs.) As a result, they have squandered much of their inheritance, instead of preserving it for future generations. Alberta and many of the indigenous peoples of Alaska have fallen into this trap. (See Gelb and Associates, 1988; Pretes and Robinson, 1990; and Robinson, Pretes, and Wuttenee, 1989.)

Attempting quickly to invest large amounts locally would almost certainly not be optimal. First, even if there are many attractive targets for investment, the absorptive capacity of the local economy is not likely to be high in the short run. Road

transportation in much of Siberia is largely non-existent. It would be a mistake to get ahead of the development of infrastructure. Second, the resource-rich regions lack the entrepreneurial and business skills needed to manage large amounts of local investment effectively; to try to import such skills would be extremely expensive. (That is an effective way to dissipate resource rents!)

Given this, it would probably be better to invest much of the rents received by subnational governments and indigenous peoples outside the local region. But investment in the rest of Russia is also problematic. It is difficult to evaluate and monitor investments, and the capital markets needed to intermediate investment of large amounts of money are essentially non-existent. The best strategy may be to invest most foreign exchange realized from the export of natural resources in world capital markets. But this brings up yet another potential concern: the honesty of public and tribal officials charged with managing foreign assets.

CONCLUDING REMARKS

The end of monolithic rule in Russia, which ideally will lead to democratic government and a market economy, has created a giant free-for-all in which many claimants (workers, managers, suppliers, pipeline companies, potential domestic and foreign investors, native peoples, etc.) are vying for the potentially enormous economic rents inherent in Russia's resource wealth. Depending on how various issues of public policy (e.g., price liberalization,

privatization, labor law, rights of native peoples) are settled, there may or may not be large amount of tax revenues to be shared by the central government and various subnational governments. A rational economic system (of pricing, wages, etc.) would probably result in enormous rents to be taxed away.

Strong economic arguments can be made for the central government taking most of these rents--which they might then share with subnational governments throughout the Federation. But if this is attempted, the governments of producing regions might prefer to leave the Federation. In the short run they may be so dependent on the central government that secession would not be a feasible alternative.

ENDNOTES

1.In 1980 a "representive tax system" would have yielded per capita revenues from energy of $4,700 in Alaska, compared to just over $50 for the nation as a whole; see Cuciti, Galper, and Lucke (1983).

2.Economic rents are the return to an investment that exceeds the amount required to call forth the investment. Rents make an ideal base for taxation, because taxes on rents do not affect investment behavior; even taxes on rents can distort other behavior. Of course, resource taxation is not limited to economic rents.

3.Environmental costs would be included in a comprehensive accounting for costs of exploiting resources, and might ideally be reflected in fees and charges related to environmental damage. Depending on the characteristics of the environmental damage, revenues from such fees and charges might appropriately belong to subnational governments. The division of these revenues among governments is not discussed further because it would ideally be based on considerations different from those that should guide the division of other resource revenues.

4.The relaxation of restrictions on residence increase the importance of this issue in Russia.

5.In addition, labor is generally much less mobile between nations than between subnational jurisdictions.

6.It is interesting to speculate why the constitutions of three large English-speaking federations, Australia, Canada, and the United States, explicitly assign the power to tax natural resources to subnational governments or do so implicitly by remaining silent on the issue. The theory of tax assignment summarized above did not exist at the time these constitutions were adopted. The enormous future importance of resource revenues was probably not fully understood. Moreover, the domain of concern has presumably grown larger over time, with the increased mobility of people, capital, and ideas.

7.In this form of taxation the worldwide profits of corporations are apportioned among jurisdictions on the basis of a formula. As applied to oil, and probably other natural resources, formula apportionment places too much of the tax base in consuming jurisdictions.

8.Given the strange way profits are measured in the former Soviet Union, it is difficult to make definitive quantitative statements about profitability, but issues are often so clear that qualitative statements are possible. In July 1992 the domestic price of oil was only about 15 percent of the world price. Even in the oil industry it is difficult to make money with that kind of pricing. Until recently other members of the Commonwealth of Independent

States, and indeed, other members of the former Soviet bloc, also shared in Russian resource rents through artificially low prices. It is probably not an exaggeration to say that the entire Soviet empire floated for years on a sea of Russian oil.

9. In addition, working conditions in some of these industries are so horrible that many Russians have sympathy for the workers; this was true of the threatened strike by coal miners in the Kuznets Basin in 1991. In a system with state ownership, consumers may fail to recognize the inherent conflict between them and miners.

10. In some cases tribes have signed simple leases with Russian oil companies that give them very little in return for the privilege of exploration on their traditional lands. It will be interesting to see how these agreements hold up in court. Uncertainty about the legal system is yet another characteristic distinguishing the Russian situation from the Western equivalent.

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Land Taxation: Lessons from International Experience

by

Colin Clark, M. A.
Director of the Agricultural Economics Research Institute, Oxford
in

Land Values

8.C - p.6-7

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Every statesman designing a system of taxation has to take into account three quite different considerations, which may often lead to conflicting conclusions, namely social justice, economic efficiency and administrative practicability.

Let us consider land taxation first from the point of view of economic efficiency. The principles of efficiency, applied to taxation, require first that it should give as little discouragement as possible to people's willingness to produce; and further that it should "distort" production as little as possible, i.e., should not encourage producers to produce more of something which consumers want less, at the expense of some other commodity which the consumers want more.

Among the range of practicable taxes, there is none which is so economically "efficient" as land tax. (It is theoretically true that an equal degree of economic efficiency would be attained by a tax on "quasi-rents," i.e., those elements in the incomes of various producers which represent a surplus above the minimum income which would have been required to have evoked their productive efforts; but a tax assessment of this sort cannot even approximately be made in practice.)

All taxes on currently earned income, to a greater or lesser degree, discourage production and the earning of income. ..... Anyone, whether wage-worker, salaried worker, manager or proprietor, who is taxed at a rate which he thinks too high, may work less energetically, or take more leisure, or possibly emigrate. A piece of land can do none of these things. On the contrary, its owner is likely to administer it with more skill and care, and put it to the best possible use, if he has to pay a substantial tax on it anyway.

And, unlike savings, land is not the fruit of past human effort. It is true that people may use their savings to buy land; but this does not affect the amount of land available, which would remain just the same if nobody or everybody used his savings to buy land (although they would have to pay very different prices for it under these varying circumstances). The amount of land available for agriculture and mining is determined by natural factors, and for urban use (in almost all cases) by the activities of people other than the owner of the land himself.

The above reasoning applies to taxes placed on land itself, and not on buildings and other structures which may have been erected upon it. These should be taxed, if at all, as lightly as possible; building is a form of production which we wish to encourage.

This brings us to the question of administrative practicability. At the time when land taxation was first thoroughly discussed in this country, about 1910, there may have been more justification than there is now for the insularity of those who said that a general valuation of all land was impracticable. In New Zealand, and in three states of Australia, a general valuation of the unimproved value (i.e., excluding all buildings, structures

and other improvements) of land has been made for many years, and is used for local taxation in place of the British system of rates. The valuation is perfectly practicable; the economic results of land taxation are satisfactory too.

The general instructions to the valuer are that, in valuing any particular property, he must first observe the prices which are being paid in the neighbourhood for similar improved properties (i.e., those carrying buildings, farm improvements, etc., similar to those on the land to be valued), make a valuation of the improved property, then deduct from this gross total his estimate of the depreciated value of the improvements (bringing the latter up from historic cost to replacement cost if, as is usually the case, there has been significant change in general costs of construction since the time when the improvements were made). The residue represents the valuation of the land.

We have dealt with economic efficiency and with administrative practicability, but we must not neglect social justice. For most people it would seem clear that the gains from land ownership should be specially taxed, most of all because so much of the gain arises out of the efforts of persons other than the owner of the land himself. ..... Speculation in land is economically beneficial; but hard work in industry is as much or more beneficial to the general economy, and at the same time is highly taxed; it seems clear on all grounds that the proceeds of speculation in land should be highly taxed too.

..... Land, whether agricultural or urban, has an "economic rent." The scientific meaning of this phrase differs greatly from the meanings often given to it in discussions on, for instance, council house

policy. The difference between the economic rents of various pieces of land is determined and measured by the difference between their potential productivity, ...

The economic rent of rural land ..... includes a non-cash element. On most properties there is shooting, and on some fishing--it is true that these can be leased, and a cash value put upon them, but their enjoyment by the owner may be worth more to him than the cash value. Likewise the opportunity for social contacts with "the County," on which some purchasers of rural estates put a very high value indeed. There is also the less definite but very real pleasure of being able to stand on one's doorstep and look out over one's own property. Economic analysis, as well as social observation, shows that there are very real economic rents here, as well as from the net cash income.

Now the most important proposition of land economics, which nearly everybody gets wrong, is that economic rents are the cause and land prices the consequence. The price of a piece of machinery or a building bears some relation to its cost of production, at any rate when it is new. Land cannot be produced and has no cost of production. It has a price solely because of revenue (cash or non-cash) expected from it, currently or at some future date.

Countless errors would be avoided if people understood this. The owner of a farm has paid a high price for his land, say the politicians, and, therefore, he is entitled to a reasonable return on it. Some economic historians have blamed high food prices in the past upon the high price of land--a straight confusion of cause and effect, showing how little economics some economic historians know. That high prices of building

land are raising the cost of new houses is a favourite proposition with many politicians today. The truth of the matter is that in some parts of the country (though certainly not everywhere) building land is scarce and therefore commands an economic rent. All that we are free to do is to decide whether the rent will go into public or private revenue--but go somewhere it must. The high price of land is just a reflection of the existence of an economic rent.

Now we had better set out the workings of a land tax, in very simple algebra. The proposition with which we conclude is one which many people seem to find it very hard to believe, namely, that a land tax reduces the price of land--which it does in the ratio (tax plus rate of interest)/tax.

Let the rate of interest (expressed as a fraction of unity, e.g., 5 per cent, as 0-05) be i
Let the rate of land tax, levied on the selling value of the land, be r
Let the selling value of the land be V
Let the full economic rent of the land (including discounted value of expectations of future rises in rent) be E
Let the full selling value of the land be F
The full selling value is the appropriate number of years' purchase of the full rent.

$$F = E/i$$

The tax levied is rV and the rent remaining to the owner of the land is (E - rV) which when capitalised gives the selling value.

$$V = (E - rV)/i$$

which can be simply rearranged as

$$V = E/(r + i)$$

or

$$E = V(r + i)$$

i.e., the full economic rent of the land is its selling value times the rate of interest, plus the rates of tax paid, which is a commonsense result. But we can also get the interesting result which cannot be inferred directly, namely, that

$$V/F = i/(i + r)$$

> Thus, if the average rate of tax is of the same order of magnitude as the rate of interest, then the actual selling value of the land will be about half of its full selling value; and by raising rates of tax sufficiently the selling value of the land can be reduced to almost any figure.

.....

Where the source of revenue is to be shared between two taxing authorities, there are some very important practical considerations which are sometimes forgotten, with serious consequences. For instance a scheme in which first the local authority and then the state imposed a tax, the latter allowing the tax paid to the local authority as deduction from the assessment, would have very bad consequences indeed. It would encourage the local authority to take more than they really needed, knowing that, because of full deductibility, their demands would have no effect on the taxpayer, though they would affect state revenue. The system in Australia, which at any rate is workable, is that all land is taxable by the local authority, and that the state taxes only holdings above a certain value in the hands of a single individual or corporation. This of course gives an incentive to distribute ownership of land among members of a family, and leaves the largest land taxes to be paid by corporations such as banks and breweries, which own large numbers of scattered valuable sites. (The above was also true of the Australian Federal Land Tax, introduced in 1910 with the deliberate object of discouraging unduly large individual holdings of land, and recently abolished.) As things are in Britain now, however, a greater aggregation may also be beneficial with urban land. A project for additional tax upon large holders of land should therefore be discouraged. The best device for Britain appears to be a uniform system of valuation, by which land values per head of population should first be ascertained; then the state would impose a

land tax which exempted altogether those local authority areas where per-head land values were low, and which rose in a progressive scale for those with higher land values per head. Each local authority would then also impose its own tax, at a rate decided by itself, the state land tax not being deductible from the assessment. This method is open to the theoretical objection that a rise in the local authority tax in a high value area reduces the selling value of the land and thus indirectly reduces the revenue of the state. It will probably be the case however that the land tax demands by local authorities in these high valued areas will not rise to a point where they would have serious effects in this direction.

It remains of course very important that each local authority should be left free to impose its own rate of tax; and that it should have to finance as many as possible of its services out of it. Economists and administrators with tidy minds would often like to impose uniform rates of tax in these circumstances, or, still worse, provide for some system of central collection and apportionment to local authorities. The advocates of such proposals fail to see that they are striking at the very roots of the principles of political responsibility. We want to see each local authority deciding on its expenditure, and then imposing the taxation necessary to meet it in full view of its electors, and responsible to them for its decisions. If any substantial fraction of a local authority's revenue comes as a grant from a higher authority, they will be much less careful in their spending of it, and will always be tempted to devote their energies in agitating for increased grants, which could better have been devoted to economising their expenditure, and increasing their area's prosperity and taxable value.

7.B

11. (letter to Busey & Venturella). George discovered he could not make hay with local politics without being swept into, not just national, but world politics. There is a worldwide comity of property and allied ideology: scratch it anywhere and it hurts everywhere. Remember the Holy Alliance? Observe how it works today through the World Bank, IMF, CIA, U.S. - A.I.D., USMC, USN, et al. HG even had to fight the Vatican, merely running for Mayor of NY; even thus, liberation theologists in Latin America get squelched from Rome today.

The Federal income tax is a tax on property income, in part. HG said of it "Even the income tax, bad as it is, is in all respects better than a tariff" (PFT, p.323). Georgists in Congress went to great pains to see to it that the income tax law of 1894 included land income in the base. Not until FDR came along did Georgists abandon their interest in Federal taxation, and let the income tax devolve into the present payroll tax.

Now, absent any Georgist input, the move is on to delete land income 100% from the income tax base.

As George said, national politics blends with local politics. You are rightly concerned that we are stronger to focus our efforts. That is doubtless one element of truth. I submit, though, we gain strength by forming alliances and showing our awareness of the greater public dialogue that includes Federal and world issues.

8.a

State May Change Policy on Farms in Urban Areas

■ Growth: The Wilson Administration no longer wants to encourage farmers near developed sites to keep their land in agriculture rather than develop it, a top official says. 31 Dec. 92, A3

By DANIEL M. WEINTRAUB
TIMES STAFF WRITER

SACRAMENTO—Giving the first solid indication of a new strategy on growth, a top state official said the Wilson Administration wants the state to abandon a policy that encourages farmers near urban areas to keep their land in agriculture rather than develop it.

The proposed policy change, according to Resources Secretary Douglas Wheeler, will be included in Gov. Pete Wilson's long-awaited growth management plan, which is scheduled to be released early next year.

The plan, according to Wheeler and another Administration official, will seek to encourage growth in places where public services already exist while discouraging development in outlying areas where roads, sewers or schools have yet to be built. Wilson implemented a similar plan when he was mayor of San Diego.

Although Wilson's general goal meshes well with policies favored by statewide advocates of growth management such as the Sierra Club, it could generate opposition from neighborhood groups that have formed to fight construction on the limited amount of open space that remains within or near city boundaries.

A key element would be the treatment of farmland under the Williamson Act, a state law that subsidizes farmers who agree not to build on their land.

Wheeler said the law needs to be changed because the state, in essence, is wasting money by paying farmers not to build on land where development is inevitable.

"If you protect agricultural land which you know is going to be converted, you are spending money not as effectively as you might otherwise," Wheeler said in an interview.

The Williamson Act, adopted in the 1960s to preserve California's dwindling supply of farmland, works by reducing property taxes for farmers who sign contracts saying they will not build on their land for at least 10 years. During the course of the contract, the land is assessed for taxes as if it were in a remote setting, where values are lower because there is little potential for development.

The closer the farm is to an urban area, the bigger the property tax reduction and the higher the cost to the state. The state last year paid $14 million to reimburse counties for the property taxes they lost under the program.

"You are paying a high premium [for that land] and you are probably engaged in an action to delay, not deter, development," Wheeler said.

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FARMS: Policy May Change

Continued from A3

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"What we are talking about is, 'If you, Mr. Homeowner, want that strawberry field preserved, then maybe you ought to pay for it,'" Sybert said. "The rest of the state, through Williamson Act funds or some other mechanism, ought not to be asked to pay for it, because if it does, you're getting subsidized by all the other taxpayers."

Cannan

Local Land Taxes as a "Tragedy of the Commons"

Alfred Marshall, who sees much merit in land taxation, also sees it as overcrowding central cities, and proposes that some land tax revenues be earmarked to a "fresh air fund" to offset this damage. Leonard Darwin (1907) carries this much further than Marshall. However, Edward Polak (1915) replies that cities generate more positive than negative spillovers.

7, A

A more challenging negative comes from Edwin Cannan. Cannan defends taxing buildings on the now familiar basis that they increase local public costs, and in proportion to building value (1907, p. 39). Buildings receive more services in large cities than small, so untaxing them will subsidize congestion in central cities. Free services to urban building create something analogous to a "tragedy of the commons," overcrowding cities and destroying rent (1907, p. 44).

Although Cannan's style is partisan, and much of his work unimpressive, this point is basic; he desperately wants an answer in light of today's exclusionary zoning and related policies. Cannan's argument needs adapting today when the suburbs outdo the central cities in their fear of fiscal parasites. Yet it is fiscal sharing more than physical congestion that concerns Cannan. His logic leads towards pooling tax revenues of whatever kind at higher levels of government, as proposed by Colin Clark. It is perhaps the great weakness of most Georgians that they have persisted in pushing land taxation purely as a local policy, thus leading right into Cannan's powerful rebuttal which currently is sweeping the field.

Inadequacy of Land as a Tax Base

Spahr (1891) and later Seligman (1895, rpt. 1923) write that marginal communities have little land value and hence no land value tax base. This is consistent with their belief that taxes on capital are borne by capital (for if local capital taxes come instead out of land rents, then a direct tax on land is simply a more efficient way of tapping the taxable surplus, which cannot exceed rent anyway [Andelson and Gaffney 1979]). It is at odds with their belief that farmers bear most of a tax on land values, a contradiction so glaring that Spahr and Seligman have little message for today. In retrospect, Edwin Cannan had a stronger point. He did not question the adequacy of rent, but the efficiency of locational incentives created by socializing rent through local taxation.

es 'sleaze'

Bush conceded the criticism was "pretty high. But I don't think it's been increasing."

He criticized the "liberal crowd" in Congress for failing to adopt his economic incentive measures, saying he would like to see more dramatic growth in the economy.

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Maryland enterprise zone test points up positives, negatives

Summer 1992

By Mitchell Zuckoff
Boston Globe

BALTIMORE

Every time President Bush outlines his plan to save U.S. cities, he's talking about Raymond V. Haysbert Sr., beef links, liver pudding and economic hope.

Haysbert is president of Parks Sausage Co., the aromatic anchor tenant of Baltimore's Park Circle industrial park, a 49-acre enclave where neat lawns have replaced glass-strewn lots and car pools have taken the place of drive-by shootings.

Park Circle is a model for a hotly debated nationwide program of "enterprise zones" that the Bush administration wants Congress to approve as a cornerstone of an urban renewal strategy. The unanswered question, and the focus of the debate, is whether enterprise zones are anything more than expensive lace curtains on burned-out neighborhoods.

Hardly a new idea, enterprise zones are targeted areas where companies receive tax breaks and other financial incentives to locate or expand. The goal is to focus jobs and public works improvements on economically depressed, high-unemployment areas that companies and public officials are accused of ignoring. "Parachute" renewal

"This has been good for everybody. We heard we'd have vandalism, drugs and worse if we moved here, but nothing has happened," said Haysbert, who estimated that his company saves more than $200,000 a year by being in the Park Circle zone. "The zone has helped this community, and the neighborhood has pride in having us here."

No one doubts that individual businesses appreciate the zones. But critics see expensive, publicly financed programs that simply rearrange the distribution of jobs and resources, with costs and expectations far exceeding results. Skeptics also say the zones are doomed to fail unless they are just one part of a comprehensive strategy that includes education, job training, access to bank credit and other measures.

While federal lawmakers have debated the issue over the past decade, 36 states already have created more than 600 enterprise zones, with an array of different financial formulas to help businesses.

The drive to extend enterprise zones nationwide through federal tax reductions languished for years, but the idea has gained powerful momentum since the Los Angeles riots after the Rodney King verdict.

At first blush, Park Circle and Parks Sausage seem to provide an archetypal formula for a successful enterprise zone: The black-owned firm has 220 employees, many of them minorities, who process 19 million pounds of meat annually.

But as critics and even some supporters point out, Park Circle and Parks Sausage can just as easily be used as an example of enterprise zones' inability to ease, much less cure, economic ills of the community, in this case Park Heights.

Bail out

Established in 1982 as one of the nation's first enterprise zones, Park Circle cost taxpayers $7 million for land purchases, sewers, water mains, power lines and new streets. In 1991, businesses in the zone received $250,000 in property tax breaks and tens of thousands more in income tax reductions for creating new jobs.

Under Maryland's program, companies that locate or expand in an enterprise zone pay only 20 percent of their property taxes for the first five years; the rate rises 10 percent a year over the next five years. Companies also get up to $3,000 in tax credits for each new employee, with the maximum going to companies that hire workers who are poor.

Yet despite the incentives, there are just 1,400 workers at the more than 60 companies located at Park Circle.

As a result, not even Park Circle's most ardent defenders would suggest it has yielded significant, tangible results for the more than 40,000 residents of the Park Heights neighborhood, where unemployment is endemic among young black men, topping 40 percent. Statewide, the impact is even smaller: Maryland's 17 enterprise zones have created only about 2,000 jobs, in exchange for about $5 million in lost tax revenue, not to mention other public investments.

At Parks Sausage, only a handful of workers are from Park Heights. The company's 1990 move to Park Circle was prompted by Baltimore's decision to build a baseball stadium at the site of the meat processor's old home, at downtown Camden Yards. Instead of creating new jobs, the move simply forced existing employees to take a different route to work.

Enterprise zone legislation

- Enterprise zone legislation approved last week in the U.S. House would represent a tentative first step toward creating a nationwide system of target areas for business investment.
- The bill would provide $2.5 billion in tax breaks to investors who put their money in any one of 50 designated areas — 25 urban and 25 rural — that are singled out as especially hungry for jobs, growth and prosperity.
- If the measure becomes law, the Bush administration would choose the 50 pilot zones based on certain criteria. An earlier proposal from the administration called for 300 zones.
- Among the tax breaks in the measure is a $3,000 annual tax credit for each employee hired from the neighborhood where the zone is located. Investors in enterprise zones also could exempt from taxes 50 percent of the capital gains on a business held more than five years. That provision was a compromise between Democrats, who wanted all gains taxed, and Republicans, who wanted them to be fully exempt.
- The legislation calls for another $2.5 billion for programs to "weed" out crime and drugs in the enterprise zones, and "seed" the areas with job training and social services.
- Although passed overwhelmingly in the House, on a 356-55 vote, the legislation is not final.

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Boston Globe

State May Change Policy on Farms in Urban Areas

■ Growth: The Wilson Administration no longer wants to encourage farmers near developed sites to keep their land in agriculture rather than develop it, a top official says. 31 Dec. 92, A3

By DANIEL M. WEINTRAUB
TIMES STAFF WRITER

SACRAMENTO—Giving the first solid indication of a new strategy on growth, a top state official said the Wilson Administration wants the state to abandon a policy that encourages farmers near urban areas to keep their land in agriculture rather than develop it.

The proposed policy change, according to Resources Secretary Douglas Wheeler, will be included in Gov. Pete Wilson's long-awaited growth management plan, which is scheduled to be released early next year.

The plan, according to Wheeler and another Administration official, will seek to encourage growth in places where public services already exist while discouraging development in outlying areas where roads, sewers or schools have yet to be built. Wilson implemented a similar plan when he was mayor of San Diego.

Although Wilson's general goal meshes well with policies favored by statewide advocates of growth management such as the Sierra Club, it could generate opposition from neighborhood groups that have formed to fight construction on the limited amount of open space that remains within or near city boundaries.

A key element would be the treatment of farmland under the Williamson Act, a state law that subsidizes farmers who agree not to build on their land.

Wheeler said the law needs to be changed because the state, in essence, is wasting money by paying farmers not to build on land where development is inevitable.

"If you protect agricultural land which you know is going to be converted, you are spending money not as effectively as you might otherwise," Wheeler said in an interview.

The Williamson Act, adopted in the 1960s to preserve California's dwindling supply of farmland, works by reducing property taxes for farmers who sign contracts saying they will not build on their land for at least 10 years. During the course of the contract, the land is assessed for taxes as if it were in a remote setting, where values are lower because there is little potential for development.

The closer the farm is to an urban area, the bigger the property tax reduction and the higher the cost to the state. The state last year paid $14 million to reimburse counties for the property taxes they lost under the program.

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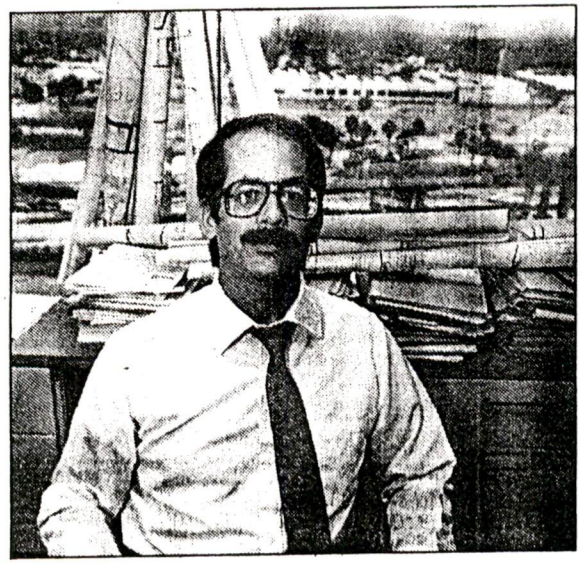
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Impact Fees Re-Examined in California

Towns Find They Can Stunt Growth In a Recession

By JERRY CHESLOW





Lilian Del Rio for The New York Times

Gerald V. Jolliffe, Riverside County planner, left; Ronald N. Short, development director at Chino Hills.

RIVERSIDE, CALIF.

There is no receptionist at the front desk of the Riverside County Planning Department. A revolving sign assures visitors that "someone will be with you in a few moments." Another notes that the agency is closed every other Friday. Just beyond is a cavernous open area filled with empty desks.

One of the fastest growing counties in California — its rate of growth was 10 percent in 1989 and 6.4 percent in 1992 — Riverside is a typical example of an area that has grown to depend on real estate impact fees to pay for vital services and develop infrastructure. When times were good, the fees helped municipalities and counties grow by making development pay for its effect on the community, like the need for more or wider roads, sewers, schools, parks, fire protection and other services.

But many of those communities have found that in a recession high fees stunt growth and that services paid for by fees have shrunk to dangerously low levels. The county's Buildings Department, for example, which gets 97 percent of its funds from impact fees, went from 197 employees in 1989 to 15 today.

"Because we depend so heavily on impact fees," said Gerald V. Jolliffe, the county's principal planner, "when building slowed, we lost the fees and with them our ability to do any advance planning. Applications for building permits now take much longer to get through the approval process and we are unable to prepare for the next development wave."

The county gets a total of $6,675 in fees for each new dwelling unit. Of these, two-thirds are classified as impact fees. They are used to cover not only the effects of new construction on public facilities but also the activities of the Building Department.

Some sections of the county have an additional fee of $1,600 an acre of development to cover the impact on the endangered Stevens kangaroo rat. Those fees are on top of other impact fees charged by municipalities and school districts, which often bring the total impact charges on new construction to more than $30,000 a unit.

Since 1978, when Broward County, Fla., became the first jurisdiction to impose impact fees, they have been challenged in the United States Supreme Court, which decided in 1987 that there must be a "rational nexus" establishing a clear connection between new growth and improvements mandated by the communities involved.

So far, at least 17 states have passed laws requiring that municipalities impose such fees. New Jersey and Connecticut have legislation to allow fees to be collected for improvements to roads and sewer, drainage and water systems. Although New York State has no such legislation, municipalities regularly force developers to make infrastructure improvements as a condition for permission to build large developments.

California's impact fees are among the highest in the country, partly to make up for shortfalls in property taxes resulting from Proposition 13. That measure, passed in a referendum in 1978, stipulates that municipalities may not increase property taxes by more than 2 percent a year on properties bought before 1978.

In May 1992, the Riverside County Planning Department tried to make up for its shortfall by asking the county's Board of Supervisors for a 60 percent increase in fees. The request was rejected after the local Building Industry Association brought representatives of all of the building trades to the meeting to persuade the supervisors that an increase would further hobble the limping construction industry.

"The supervisors understood that raising fees when building activity drops is like beating a dead horse," said Thomas Van Voorst, executive director of the Riverside County Building Industry Association. "What you really need is to lower fees to stimulate the market."

"For every $1,000 in additional fees you lose 7 percent of the market," says Stephen Johnson, a partner in the Meyers Group, an [illegible] which is about 170 empty lots, was

estate trends in Southern California. "The more fees you impose, the more middle- and lower-income people are shut out of the market."

The most extreme example of a community groaning under the weight of impact fees is Chino Hills, a posh city of 44,000 with rolling hills and bridle paths. It is in San Bernardino County, just west of Chino, and abuts Los Angeles and Orange Counties. It was started by San Bernardino County in 1982 as a bedroom community to serve larger employment centers nearby. All of its infrastructure was to be financed through impact fees, which started at $4,200 per dwelling unit.

•

On Jan. 1, 1992, Chino Hills was chartered as a city, with excellent road and park systems financed by fees that now total more than $40,000 per dwelling unit. These include development fees of $36,000 that are charged when the building permit is issued and school fees of $2.65 per square foot of construction.

"Often the fees total more than the cost of the land," said Ronald N. Short, Director of Community Development at Chino Hills.

One of the first actions taken by the new City Council was to authorize an evaluation of the impact fee structure that had been put in place by the county. The Council found that although large one-family homes were still selling because of the natural beauty and the location of the city, the fees had all but ruled out other development. Its one low- to-moderate-income area, the Los Serranos neighborhood which is about 170 empty lots, was deteriorating. There was virtually no commercial development because the county had set commercial fees at an average of 9.2 times those of residential.

"We would try to bring in commercial development," said Mr. Short, "and they would have to pay $160,000 an acre just in fees. That was outrageous and no one would go for it."

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The city, which gets 1 percent of all state and county sales taxes collected within its boundaries, expects to reap $700,000 a year in sales taxes alone from the power center, which would more than double the amount of sales tax revenue currently collected. Construction is expected to begin before year's end.

Mr. Short says that the recession made Chino Hills begin to examine its fee schedule because there was considerable competition for the little commercial development taking place in Southern California. However, he said, the current reduction in fees is just the start of a process that he hopes will lead to a complete restructuring of the fee schedule.

"We are looking at all of our fees and comparing them with what other communities in our area are doing," he said. "We've already found some ridiculous inequities. For instance, we charge $19.05 per square foot in impact fees for restaurant development. In Chino, it's $1.35. So who in his right mind would build a nice restaurant here? For regular retail stores, our fees come to $14.44 a square foot, as opposed to 64 cents in Chino."

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"We realized that the idea of making development pay for itself is good to a degree," he said. "But sometimes that can be an oversimplification. You have to look at the fee structure in terms of the goals of the town, and by reducing our fees, we are actually in a lot better shape on our operating budget." ■

804, n.1 "The difficulty of assessment … is of a kind to be diminished rapidly by experience: …" The first thousand would be tougher than the next 20,000.

Stat. on the growth of wealth

238, various estimates pre-1905, various nations. Vague, dubious.

Representative firm

317, a fuzzy, worthless definition.

Rents

422, land is like an "element," e.g. oxygen or sodium, and retains its identity when mixed with other elements. "… separate reasonings are required for those parts of its (land's) value which are, and those which are not, due to efforts of man …"

n.1 Scores Fetter for "The passing of the concept of Rent, QJE May 1901. Fetter just doesn't get it.

Jevons on Ricardo

813-21, app. I (eye), defends Ricardo on value, scores Jevons for misunderstanding Ricardo. We must interpret Ricardo as "his writings indicate that he would have wished us to give them."

822 ff., App. J, explains wages-fund. Excellent, fair interpretation.

duties toward the very poor." (These national duties are locally collected?) Solution is "widening the areas of rating for some purposes, so as to include poor and rich districts under the same budget, ..." Implies this happens quickly. Anyway, we have Marshall on record favoring shifting many taxes to central govt., p. 798.

798, shifting of onerous building taxes to land may fall on local landowners, but helps landowners elsewhere by shifting capital there. (No mention of capital export - in England, major exporter of capital!)

798, incidence of rates "is vitally affected by the proportions in which the rate is assessed on site and building values respectively."

800, assessing rising outlying land at its capital value (vs. current rent) "would hasten on building," thus transferring part of the public value of land to the public at large.

800, lvt applied to entire metrop. would cause more concentration. Or might not: "it is difficult to say." Building by-laws might determine the net result.

801, land resembles capital in some ways, and not in others. Is a recent "tendency to relegate the points of difference to a secondary place." This might be judicious if true, "But the contrary is the fact."

802, "large expenditure generally requires large house-room; ..." Taxes on expenditure present great tech difficulties to the tax collector, and have great excess burdens, taxes on houses are technically simple, cheap in collection, not liable to evasion, and easy of graduation." Thus, recommends housing taxes as consumer taxes.

802, would tax business lower than houses.

802-3, "from the economic and from the ethical point of view, land must everywhere and always be classed as a thing by itself."

"If from the first the State had retained true rents in its own hands, the vigour of industry and accumulation need not have been impaired, ..."

803, concentration causes high site values. These values are not only public, but concentration damages the public by congestion. So, tax site values to pay for parks etc. The king made landholders to work for the public well being; "they have no right to mar that well-being by congested building."

804, all land, urban or not, has a special public value. Value is what bare site would sell for, if cleared of buildings (BUILDING-RESIDUAL).

"**It might then be subjected to a general rate assessed on its capital value;** and, IN ADDITION, to a fresh air rate ..."

Land Taxation: Lessons from International Experience

by

Colin Clark, M. A.
Director of the Agricultural Economics Research Institute, Oxford
in

Land Values

Edited by Peter Hall

Sweet & Maxwell, Limited: London

1956

Every statesman designing a system of taxation has to take into account three quite different considerations, which may often lead to conflicting conclusions, namely social justice, economic efficiency and administrative practicability.

Let us consider land taxation first from the point of view of economic efficiency. The principles of efficiency, applied to taxation, require first that it should give as little discouragement as possible to people's willingness to produce; and further that it should "distort" production as little as possible, i.e., should not encourage producers to produce more of something which consumers want less, at the expense of some other commodity which the consumers want more.

Among the range of practicable taxes, there is none which is so economically "efficient" as land tax. (It is theoretically true that an equal degree of economic efficiency would be attained by a tax on "quasi-rents," i.e., those elements in the incomes of various producers which represent a surplus above the minimum income which would have been required to have evoked their productive efforts; but a tax assessment of this sort cannot even approximately be made in practice.)

All taxes on currently earned income, to a greater or lesser degree, discourage production and the earning of income. ..... Anyone, whether wage-worker, salaried worker, manager or proprietor, who is taxed at a rate which he thinks too high, may work less energetically, or take more leisure, or possibly emigrate. A piece of land can do none of these things. On the contrary, its owner is likely to administer it with more skill and care, and put it to the best possible use, if he has to pay a substantial tax on it anyway.

And, unlike savings, land is not the fruit of past human effort. It is true that people may use their savings to buy land; but this does not affect the amount of land available, which would remain just the same if nobody or everybody used his savings to buy land (although they would have to pay very different prices for it under these varying circumstances). The amount of land available for agriculture and mining is determined by natural factors, and for urban use (in almost all cases) by the activities of people other than the owner of the land himself.

The above reasoning applies to taxes placed on land itself, and not on buildings and other structures which may have been erected upon it. These should be taxed, if at all, as lightly as possible; building is a form of production which we wish to encourage.

This brings us to the question of administrative practicability. At the time when land taxation was first thoroughly discussed in this country, about 1910, there may have been more justification than there is now for the insularity of those who said that a general valuation of all land was impracticable. In New Zealand, and in three states of Australia, a general valuation of the unimproved value (i.e., excluding all buildings, structures

and other improvements) of land has been made for many years, and is used for local taxation in place of the British system of rates. The valuation is perfectly practicable; the economic results of land taxation are satisfactory too.

The general instructions to the valuer are that, in valuing any particular property, he must first observe the prices which are being paid in the neighbourhood for similar improved properties (i.e., those carrying buildings, farm improvements, etc., similar to those on the land to be valued), make a valuation of the improved property, then deduct from this gross total his estimate of the depreciated value of the improvements (bringing the latter up from historic cost to replacement cost if, as is usually the case, there has been significant change in general costs of construction since the time when the improvements were made). The residue represents the valuation of the land.

We have dealt with economic efficiency and with administrative practicability, but we must not neglect social justice. For most people it would seem clear that the gains from land ownership should be specially taxed, most of all because so much of the gain arises out of the efforts of persons other than the owner of the land himself. ..... Speculation in land is economically beneficial; but hard work in industry is as much or more beneficial to the general economy, and at the same time is highly taxed; it seems clear on all grounds that the proceeds of speculation in land should be highly taxed too.

..... Land, whether agricultural or urban, has an "economic rent." The scientific meaning of this phrase differs greatly from the meanings often given to it in discussions on, for instance, council house

policy. The difference between the economic rents of various pieces of land is determined and measured by the difference between their potential productivity, ...

The economic rent of rural land ..... includes a non-cash element. On most properties there is shooting, and on some fishing--it is true that these can be leased, and a cash value put upon them, but their enjoyment by the owner may be worth more to him than the cash value. Likewise the opportunity for social contacts with "the County," on which some purchasers of rural estates put a very high value indeed. There is also the less definite but very real pleasure of being able to stand on one's doorstep and look out over one's own property. Economic analysis, as well as social observation, shows that there are very real economic rents here, as well as from the net cash income.

Now the most important proposition of land economics, which nearly everybody gets wrong, is that economic rents are the <u>cause</u> and land prices the <u>consequence</u>. The price of a piece of machinery or a building bears some relation to its cost of production, at any rate when it is new. Land cannot be produced and has no cost of production. It has a price solely because of revenue (cash or non-cash) expected from it, currently or at some future date.

Countless errors would be avoided if people understood this. The owner of a farm has paid a high price for his land, say the politicians, and, therefore, he is entitled to a reasonable return on it. Some economic historians have blamed high food prices in the past upon the high price of land--a straight confusion of cause and effect, showing how little economics some economic historians know. That high prices of building

land are raising the cost of new houses is a favourite proposition with many politicians today. The truth of the matter is that in some parts of the country (though certainly not everywhere) building land is scarce and therefore commands an economic rent. All that we are free to do is to decide whether the rent will go into public or private revenue--but go somewhere it must. The high price of land is just a reflection of the existence of an economic rent.

Now we had better set out the workings of a land tax, in very simple algebra. The proposition with which we conclude is one which many people seem to find it very hard to believe, namely, that a land tax reduces the price of land--which it does in the ratio (tax plus rate of interest)/tax.

Let the rate of interest (expressed as a fraction of unity, e.g., 5 per cent, as 0-05) be i
Let the rate of land tax, levied on the selling value of the land, be r
Let the selling value of the land be V
Let the full economic rent of the land (including discounted value of expectations of future rises in rent) be E
Let the full selling value of the land be F
The full selling value is the appropriate number of years' purchase of the full rent.

$$F = E/i$$

The tax levied is rV and the rent remaining to the owner of the land is (E - rV) which when capitalised gives the selling value.

$$V = (E - rV)/i$$

which can be simply rearranged as

$$V = E/(r + i)$$

or

$$E = V(r + i)$$

i.e., the full economic rent of the land is its selling value times the rate of interest, plus the rates of tax paid, which is a commonsense result. But we can also get the interesting result which cannot be inferred directly, namely, that

$$V/F = i/(i + r)$$

> Thus, if the average rate of tax is of the same order of magnitude as the rate of interest, then the actual selling value of the land will be about half of its full selling value; and by raising rates of tax sufficiently the selling value of the land can be reduced to almost any figure.

.....

Where the source of revenue is to be shared between two taxing authorities, there are some very important practical considerations which are sometimes forgotten, with serious consequences. For instance a scheme in which first the local authority and then the state imposed a tax, the latter allowing the tax paid to the local authority as deduction from the assessment, would have very bad consequences indeed. It would encourage the local authority to take more than they really needed, knowing that, because of full deductibility, their demands would have no effect on the taxpayer, though they would affect state revenue. The system in Australia, which at any rate is workable, is that all land is taxable by the local authority, and that the state taxes only holdings above a certain value in the hands of a single individual or corporation. This of course gives an incentive to distribute ownership of land among members of a family, and leaves the largest land taxes to be paid by corporations such as banks and breweries, which own large numbers of scattered valuable sites. (The above was also true of the Australian Federal Land Tax, introduced in 1910 with the deliberate object of discouraging unduly large individual holdings of land, and recently abolished.) As things are in Britain now, however, a greater aggregation may also be beneficial with urban land. A project for additional tax upon large holders of land should therefore be discouraged. The best device for Britain appears to be a uniform system of valuation, by which land values per head of population should first be ascertained; then the state would impose a

land tax which exempted altogether those local authority areas where per-head land values were low, and which rose in a progressive scale for those with higher land values per head. Each local authority would then also impose its own tax, at a rate decided by itself, the state land tax not being deductible from the assessment. This method is open to the theoretical objection that a rise in the local authority tax in a high value area reduces the selling value of the land and thus indirectly reduces the revenue of the state. It will probably be the case however that the land tax demands by local authorities in these high valued areas will not rise to a point where they would have serious effects in this direction.

It remains of course very important that each local authority should be left free to impose its own rate of tax; and that it should have to finance as many as possible of its services out of it. Economists and administrators with tidy minds would often like to impose uniform rates of tax in these circumstances, or, still worse, provide for some system of central collection and apportionment to local authorities. The advocates of such proposals fail to see that they are striking at the very roots of the principles of political responsibility. We want to see each local authority deciding on its expenditure, and then imposing the taxation necessary to meet it in full view of its electors, and responsible to them for its decisions. If any substantial fraction of a local authority's revenue comes as a grant from a higher authority, they will be much less careful in their spending of it, and will always be tempted to devote their energies in agitating for increased grants, which could better have been devoted to economising their expenditure, and increasing their area's prosperity and taxable value.

MARC. YOU PROBABLY KNOW ALL THIS BY HEART.

Impact Fees Re-Examined in California

Towns Find They Can Stunt Growth In a Recession

By JERRY CHESLOW

RIVERSIDE, CALIF.

There is no receptionist at the front desk of the Riverside County Planning Department. A revolving sign assures visitors that "someone will be with you in a few moments." Another notes that the agency is closed every other Friday. Just beyond is a cavernous open area filled with empty desks.

One of the fastest growing counties in California — its rate of growth was 10 percent in 1989 and 6.4 percent in 1992 — Riverside is a typical example of an area that has grown to depend on real estate impact fees to pay for vital services and develop infrastructure. When times were good, the fees helped municipalities and counties grow by making development pay for its effect on the community, like the need for more or wider roads, sewers, schools, parks, fire protection and other services.

But many of those communities have found that in a recession high fees stunt growth and that services paid for by fees have shrunk to dangerously low levels. The county's Buildings Department, for example, which gets 97 percent of its funds from impact fees, went from 197 employees in 1989 to 15 today.

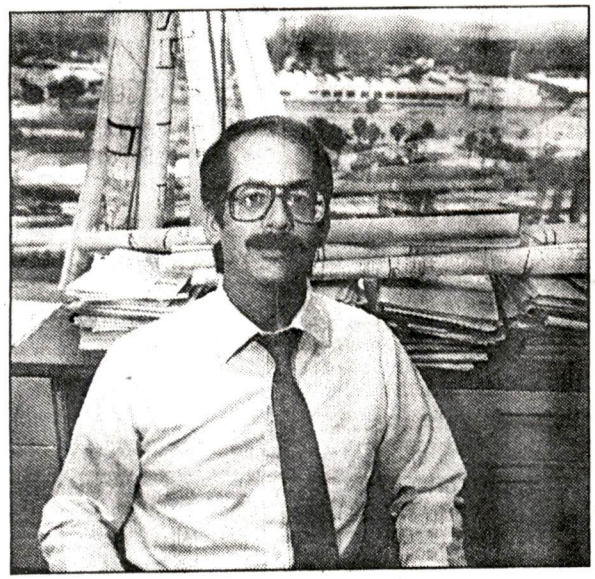
"Because we depend so heavily on impact fees," said Gerald V. Jolliffe, the county's principal planner, "when building slowed, we lost the fees and with them our ability to do any advance planning. Applications for building permits now take much longer to get through the approval process and we are unable to prepare for the next development wave."

The county gets a total of $6,675 in fees for each new dwelling unit. Of these, two-thirds are classified as impact fees. They are used to cover not only the effects of new construction on public facilities but also the activities of the Building Department.

Some sections of the county have an additional fee of $1,600 an acre of development to cover the impact on the endangered Stevens kangaroo rat. Those fees are on top of other impact fees charged by municipalities and school districts, which often bring the total impact charges on new construction to more than $30,000 a unit.

Since 1978, when Broward County, Fla., became the first jurisdiction to impose impact fees, they have been challenged in the United States Supreme Court, which decided in 1987 that there must be a "rational nexus" establishing a clear connection between new growth and improvements mandated by the communities involved.

So far, at least 17 states have passed enabling legislation to let counties and municipalities impose such fees. New Jersey and Connecticut have legislation to allow fees to be collected for improvements to roads and sewer, drainage and water systems. Although New York State has no such legislation, municipalities regularly force developers to make infrastructure improvements as a condition for permission to build large developments.





Lilian Del Rio for The New York Times

Gerald V. Jolliffe, Riverside County planner, left; Ronald N. Short, development director at Chino Hills.

California's impact fees are among the highest in the country, partly to make up for shortfalls in property taxes resulting from Proposition 13. That measure, passed in a referendum in 1978, stipulates that municipalities may not increase property taxes by more than 2 percent a year on properties bought before 1978.

In May 1992, the Riverside County Planning Department tried to make up for its shortfall by asking the county's Board of Supervisors for a 60 percent increase in fees. The request was rejected after the local Building Industry Association brought representatives of all of the building trades to the meeting to persuade the supervisors that an increase would further hobble the limping construction industry.

"The supervisors understood that raising fees when building activity drops is like beating a dead horse," said Thomas Van Voorst, executive director of the Riverside County Building Industry Association. "What you really need is to lower fees to stimulate the market."

"For every $1,000 in additional fees you lose 7 percent of the market," says Stephen Johnson, a partner in the Meyers Group, an independent research firm that studies real estate trends in Southern California. "The more fees you impose, the more middle- and lower-income people are shut out of the market."

The most extreme example of a community groaning under the weight of impact fees is Chino Hills, a posh city of 44,000 with rolling hills and bridle paths. It is in San Bernardino County, just west of Chino, and abuts Los Angeles and Orange Counties. It was started by San Bernardino County in 1982 as a bedroom community to serve larger employment centers nearby. All of its infrastructure was to be financed through impact fees, which started at $4,200 per dwelling unit.

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One of the first actions taken by the new City Council was to authorize an evaluation of the impact fee structure that had been put in place by the county. The Council found that although large one-family homes were still selling because of the natural beauty and the location of the city, the fees had all but ruled out other development. Its one low- to-moderate-income area, the Los Serranos neighborhood, which has about 170 empty lots, was deteriorating. There was virtually no commercial development because the county had set commercial fees at an average of 9.2 times those of residential.

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F: Marshall

Notes by Mason Gaffney

Economists use "quasi-rent" to mean incomes that are almost like land rent in the short run, i.e. before buildings can be either replaced or augmented, and before they depreciate away. It is one of several devices economists use to minimize the differences between land and capital, and even labor.

In Webster's (the standard American) dictionary, "quasi" means "closely resembling, or sharing many characteristics with," etc.

However, the term originated with Alfred Marshall of Cambridge and Oxford, and he would have looked up words in the OED. Here we find a meaning more like specious, cosmetic, mock, or phony: "seemingly, but not really;" "simulating, but not really the same as that properly so termed."

It seems that the term "quasi-rent" underwent a sea-change crossing the Atlantic, and what Marshall called phony was converted into something more like the real thing! We cannot dismiss this as a mere nuance of difference.

This could have been an accident of the American language; or it could have reflected the lifelong obsessions of J.B. Clark, E.R.A. Seligman, R.T. Ely, Frank Fetter, Alvin Johnson, Frank Knight, and others with obliterating the distinction of land rent from other incomes.

Before concluding that Marshall's intent was misrepresented, however, we should take into account a statement by his Palgrave biographer, J.K. Whitaker, that one of the few contemporaries whom Marshall admired was J.B. Clark himself. This does not, of course, mean that Marshall followed Clark slavishly. Whitaker does not state the basis for this admiration, and we know that Clark's long review of Marshall's Principles devotes many pages to scolding Marshall for retaining any distinction of land and capital. "Quasi-rent" may have been Marshall's compromise, a compromise that meant one thing in Britain and another in America! Both Marshall and Clark were subtle; I doubt that this difference, which is more than a nuance, escaped them. It has, however, escaped most of the rest of us ever since.

But see attack on Fetter p. 422 n. 1

Marshall

studies show corporate shares to be held more closely than "real

estate." Many property tax opponents conclude from this that property taxes exempt the wealthiest. I am not aware, however, of any systematic study refuting the belief that corporations are our major landholders, as documented in Gaffney (1970).

Mixed, or Shifting and Changeable Positions

Francis A. Walker thought that George overstated his case inexcusably. We have discussed Walker on his feelings about concentration. He also attacks George's forecast that rents will continue to rise with increased population, because the evolution of technology is labor-saving and resource-using, and because higher incomes lead to higher demand for land. Walker cites M. Leroy-Beaulieu, "an economist and statistician of eminence," who said that rent "will soon disappear altogether" (Walker 1883b, p. 147). Chicagoan Theodore Schultz (1953) says much the same.

In truth, the periodic collapse of land values in our history of cyclical territorial expansion has weakened support for land taxation; George's forecasts were overdrawn and premature. But now, one hundred years later, land values are looming up as George warned.

Walker's hostility to George is more stylistic and personal than substantive. Walker remains a Ricardian, and tackles J.B. Clark for treating capital as though it were fixed, like land (1888, pp. 417-35). In *Land and Its Rent,* after a furious attack on George, Walker still says in regard to the rights of property, "property in land stands lower, much lower in the hierarchy than property in capital" (1883b, p. 198). Before he is through, the eminent M. Leroy-Beaulieu "can command little conviction" (1883b, p. 191).

Five years later, Walker has mellowed so far as to accept land taxation as reasonable in principle but impracticable in implementation (1888, pp. 415-17).

Alfred Marshall (1920, rpt. 1947) improves upon Ricardo by contributing a new concept, the "public value of land," to help define the desired tax base. Ricardo wrote mainly of farmland and fertility differences and perverse readers persisted in taking this narrowly. Marshall's public value is what George means by "community-created" value, the joint product of nature, location, public works and

services, settlement, and community synergy. Marshall realizes that urban location values are outgrowing farm values, and he provides an appropriate concept.

Marshall also develops a lucid statement of how high urban land costs cause intensive land use by actuating substitution of capital for dear land

(1920, rpt. 1947, chap. XI). Marshall is also clear that "from the economic and from the ethical point of view, land must everywhere and always be classed as a thing by itself" (1920, rpt. 1947, appendix G). He seems to favor a kind of creeping land tax.

But Marshall is ambivalent and cautious, the very type of Harry Truman's two-handed economist. For every proposal there is a caveat, for every aid to one side, comfort to the other. Any change should be slow - during one 1883 lecture, he discusses the merit of nationalizing land interests after one hundred years (1883, rpt. 1969). It is a sobering thought that that centennial is now only two years away.

Marshall also contributes new concepts for the Omelette School, which resist unscrambling land and capital. Durable capital earns "quasirents," in the short run just like land rents. Big land developers consciously create values that spill over onto neighboring lands that they own. The supply of *national* capital is fixed, so a uniform national tax on building values is neutral, and not shifted (this is the "new view" Harberger thesis again).

Marshall distinguishes "onerous" and "beneficial" local taxes. An onerous" rate is one which taxes property to provide services to people - for example, "a poor-rate levied on the well-to-do" (1920, rpt. 1947, p. 794) -and so fails to give back to property a service equal to what it pays for. This is cousin to Cannan's tragedy-of-commons case against taxing local land values to provide services that attract immigrants and congest cities. But where Cannan focuses on people moving in, Marshall sees the wealthy moving out to the suburbs. Having raised the issue, however, Marshall characteristically minimizes it - he says that the rich cannot escape because tax jurisdictions are widened to catch them in their new locations.

Still, Marshall provides the framework for today's mischievously potent slogan, that property should pay only for services to property. These are "beneficial";

services to people are "onerous." The viewpoint is clearly that of the local landholder.

Marshall resented Henry George's influence in England, and in 1883 he took the stump against him. As with Walker, differences of style overrode substance, and no doubt George seemed a cocky intruder in Marshall's nation and profession. George developed his attitudes in a land that either belonged to the national government or was only freshly granted to private holders; Marshall's England had its own history. Marshall mainly objected to the immediacy of George's reforms.

The mature Marshall never published these immature polemics, and wisely so. George Stigler (1969) has exhumed them, possibly in the belief they show the real Marshall. But yet another George (Prime Minister

Lloyd) did win Marshall's support for a British land tax when he proposed it in 1909 (Hutchison 1969, pp. 248-49, n. 50). The real Alfred Marshall is probably the one who stood up when push came to shove in his native land. Hostility to an invader is one thing: conviction on principle is another.

Local Land Taxes as a "Tragedy of the Commons"

Alfred Marshall, who sees much merit in land taxation, also sees it as overcrowding central cities, and proposes that some land tax revenues be earmarked to a "fresh air fund" to offset this damage. Leonard Darwin (1907) carries this much further than Marshall. However, Edward Polak (1915) replies that cities generate more positive than negative spillovers.

A more challenging negative comes from Edwin Cannan. Cannan defends taxing buildings on the now familiar basis that they increase local public costs, and in proportion to building value (1907, p. 39). Buildings receive more services in large cities than small, so untaxing them will subsidize congestion in central cities. Free services to urban building create something analogous to a "tragedy of the commons," overcrowding cities and destroying rent (1907, p. 44).

Although Cannan's style is partisan, and much of his work unimpressive, this point is basic; he desperately wants an answer in light of today's exclusionary zoning and related policies. Cannan's argument needs adapting today when the suburbs outdo the central cities in their fear of fiscal parasites. Yet it is fiscal sharing more than physical congestion that concerns Cannan. His logic leads towards pooling tax revenues of whatever kind at higher levels of government, as proposed by Colin Clark. It is perhaps the great weakness of most Georgians that they have persisted in pushing land taxation purely as a local policy, thus leading right into Cannan's powerful rebuttal which currently is sweeping the field.

Marshall, Alfred, 1920. Principles of Economics. 8th Ed. (orig. 1890). 7th Printing, 1959. NY: The Macmillan Company, 1948.

Urban Land

168, after buildings rise high enough, it is better to pay more rent (he ~~always~~ often assumes urban land is rented rather than bought) to expand laterally. "From this it results that the theory of (urban) ground rents is substantially the same as that of farm rents."

448, same idea developed more.

169, the idea of diminishing returns may be applied to any disproportion, but generalizing it must be used with caution, because one is apt to assume that the crowded input may be increased. I.e., one is apt to deny that land is fixed. In fact, even the individual farmer may not be able to expand next to his own farm. "And in that respect land differs from most other agents of production, even from the individual point of view." From the social point of view, the difference is vital - and leads to the ff. chaps. on population.

441, site value is that which land would have "if cleared of buildings and sold in a free market." BUILDING-RESIDUAL METHOD.

442, most site value is "public value" - defined on p.433, re agric. land.

433, a tax on the public value of land cannot be shifted.

434, "A tax on the public value of land does not greatly diminish the inducements to cultivate the land highly, nor to erect farm buildings on it."

450, "Thus the industrial demand for land is in all respects parallel to the agric."
"... the printing presses ... at work in London some 60' above the ground, could afford to do their work a little cheaper if the demand for ground for other uses did not push the margin of building up so high."

794, onerous v. beneficial rates.

796-7, If a bldg is locationally obsolescent, the whole value may be only that of the site.

797, Lessees do not care if they pay ground rent or site taxes. Site taxes, if onerous, lower pvt. rents by an equal amount.

797, "Taxes on building values are on a different footing." 798, if they are onerous, and local, they are shifted to landowners (ATCOR) - and, in the process, stifle some building.

Cases of local onerous taxes, which are higher in some towns than others, are few and unimportant. Except for one "broad and perhaps permanent cause," the movement of the well-to-do to suburbs, leaving the "working classes" to bear the burden of "national