7 *George F. Break*

Henry George and Tax Reform—100 Years Later

In this year of grass-roots tax rebellion—I carefully avoid using the word "reform"—it is particularly appropriate to examine the work of that great 19th century tax guru, Henry George, messiah of a vigorous subculture that is alive and well and invariably adept at infusing its theology into any tax discussion. As was Proposition 13, Henry George's crowning work, *Progress and Poverty,* was born in California, and although I do not wish to push the comparison too far, they share fundamental elements that give them, despite the century that separates them, an unmistakable kinship—notably the passionate intensity and simplistic reasoning that constitute their very warp and woof.

Henry George and Adam Smith's Canons of Taxation

To a modern tax economist more interested in the pragmatic than the philosophical (or theological) aspects of George's reasoning, one of the most interesting sections of *Progress and Poverty* is the one which immediately follows the revelation in Book VIII of his "simple yet sovereign remedy" for curing society's ills by abolishing "all taxation save that upon land values" (1879, rpt. 1960, p. 406). Acknowledging that the infallibility of his prescription may not at once be apparent to all his readers, George proceeds to "try the remedy . . . by the accepted canons of taxation" (1879, rpt. 1960, p. 407). Although anyone familiar with the classic "maxims" of Adam Smith will recognize the source of these "accepted canons," George treats them as though they were as universally conceived as the laws delivered to Moses on Mt. Sinai. The number, general format, and some of the phraseology are patently Smith's, but no direct mention of that source is made until late in the chapter. At that point, George launches boldly into battle with Smith's definition of tax equity without acknowledging the extent of his debt to the great Scot; at last and at least, however, he there quotes his source instead of merely paraphrasing him without credit.

Despite such borrowings, George's treatment of the subject is entirely his own. He is a new and different Moses receiving a revised edition of the law. He makes free with the original version, preserving its essential framework but shifting points about, adding, and deleting. Though still four in number, his commandments have a strikingly new order and emphasis. In this version the first is last and the last first.

Smith's monumental equity—or "equality"—maxim has been dropped to fourth place and fundamentally altered. In its stead at the top of the list is a succinct paraphrase of Smith's double-barrelled Maxim Number 4, entitled "economy of collection" but actually encompassing the far broader concept of economic efficiency. George has elevated Smith's point about neutrality to separate status, emphasized its importance for economic growth, and made it the first "condition" for a good tax:

> 1. That it bear as lightly as possible upon production—so as least to check the increase of the general fund from which taxes must be paid and the community maintained (1878, rpt. 1960, p. 408).

The opening part of Smith's fourth maxim then becomes George's second canon, its wording so similar as to be an uncomfortably close echo:

> 2. That it be easily and cheaply collected, and fall as directly as may be upon the ultimate payers—so as to take from the people as little as possible in addition to what it yields the government (1879, rpt. 1960, p. 408).

George's third canon is Smith's "certainty" rule (Maxim Number 2), tightened in phrasing and deftly summarized:

> 3. That it be certain—so as to give the least opportunity for tyranny or corruption on the part of officials, and the least temptation to lawbreaking and evasion on the part of the taxpayers (1879, rpt. 1960, p. 408).

The fourth of George's canons is vaguely worded, deliberately sidestepping Smith's clear and ringing phrases defining "equality" as the principle of taxing people "in proportion to their respective abilities":

4. "That it bear equally – so as to give no citizen an advantage or put any at a disadvantage, as compared with others " (1879, rpt. 1960, p. 408).

Here the revisionist Moses marches to a totally different drummer, as anyone who has followed his logic through the book will find no surprise. "Equality" for George is not measured quantitatively but qualitatively. The needs of the taxpayer and the source of his money make some incomes more equal than others. This will be discussed in detail later.

In discussing the application of his four canons to the world, George shows himself to be more priest than pragmatist, or as Alfred Marshall put it, "by nature a poet, not a scientific thinker" (1883, rpt. 1969, p. 186). Reading George's words today, one is struck by his perceptive insights into human nature and the pathos of the human condition – a view as relevant today, in many respects, as a century ago. At the same time one is discouraged by the consistency of his tunnel vision, especially the narrowness of his purview, the facile nature of many of his arguments, and his bold use of assertion in lieu of evidence or deductive proof. As was Hamlet's gravedigger, George is uncommonly "absolute."

George deals only with the substitution effects of different taxes which he has labelled as bad – those on manufacturers, commerce, capital, and improvements – while ignoring the income effects. Judged solely on that basis, these taxes are seen to discourage economic activity and hence do not measure up to the first canon. In contrast, the same logic finds that land taxation has no substitution effects but instead only a special kind of income effect; therefore it either leaves economic activity unaffected or may actually encourage it, since it is based on potential rather than actual income and thus induces "highest and best use."

This reasoning, while persuasive to many, is specious. It results in incomplete analysis of both categories of tax. In fact it can be demonstrated that most or all existing taxes, including the land tax, have both substitution and income effects. Any tax on potential rather than actual income or output has zero substitution effects. In such cases the marginal rate of tax is zero. There is nothing unique about land as a tax base in this respect. Any tax on potential values, furthermore, is subject to an important additional hazard, namely, its vulnerability not only to administrative error but to the very demons named by George in his third canon – tyranny and corruption.

Administration

If George's analysis of Canon Number 1 raises serious questions, his treatment of Canon Number 2 is little better. Once again, and more explicitly, he rests his case for the land tax confidently on the assumption that the value of land "can be readily ascertained." Take that for granted, and it can be clearly seen that "A tax on land values can, of all taxes, be most easily and cheaply collected" (1879, rpt. 1960, p. 414). Pull that rug out from under him, however, and the point becomes shaky indeed. The basis for George's confidence in his position was clearly indicated in a lecture he gave at Oxford in 1884, an occasion which brought him into direct confrontation with Alfred Marshall. The report in the *Oxford Journal,* fascinatingly entitled, "Mr. Henry George at Oxford, Disorderly Meeting," summarized his remarks:

> In the United States, although their system of taxation was, in some respects, worse than ours, in others it was better, so that system would enable him to explain what he meant. Their local taxes were by the assessment on the value of all property; once every year all property was assessed, or supposed to be assessed. The value of land was assessed separately, then the value of buildings and other things. What he proposed was simply that they should levy their taxes on the value of land, and exempt all buildings and improvements (Marshall 1883, rpt. 1969, p. 220).

Only that and nothing more. Anyone who has wrestled with an assessment problem in today's urbanized world, where property values are changing rapidly, can only shake the head and wish things could be so simple. Where parcels of land cannot readily be compared because they are not uniformly adaptable to given purposes, not equally convenient to build upon, or for other reasons not similarly desirable, their values (even current, let alone potential) are by no means easy to assess accurately. In addition, where little vacant land exists, even lots of similar size offer serious problems of valuation since market data do not make the critical separation between the price of the land and the price of the improvements. Even for recent sales this breakdown is largely "guesstimation," and determining "highest and best use" values for land in areas where few if any vacant land sales have taken place for years means placing quite abstract figures on all parcels. "Cleared" land cannot be compared to "vacant" land; a vast array of variables must be introduced into each computation. In such a process accuracy can be achieved only at great cost and trouble, or as many assessors point out, reliance must be placed on expert opinion. (See Chapter 4.)

Incidence

George makes another assumption in Canon Number 2 which looks less safe today than it once did. That one concerns the incidence of the land tax, which (with the backing of classical economic theory) he takes to "fall as directly as may be upon the ultimate payers." It has generally been accepted, since Ricardo drove the point home, that a tax on the site value of land cannot be shifted but is simply capitalized into lower land values. Everyone has known that—that is, until recently. In an article aptly titled "The Surprising Incidence of a Tax on Pure Rent: A New Answer to an Old Question," Martin Feldstein rather persuasively shoots down even that deep-rooted bit of conventional wisdom (1977, pp. 349–60). This act of iconoclasm will probably not erode the faith of true believers, but it seriously challenges one of the cardinal assumptions that have made the land tax appealing to many thoughtful adherents.

Feldstein argues that a tax on pure rent is indeed shifted, both in the short run and in the long run. The short-run result comes from the manuevering of investors to balance their portfolios in the near term, when the reproducible capital shock is in effect fixed. As investors weigh different assets on the basis of their relative current yields and risk characteristics, they find that a reduction in the price of land (as a result of imposing a land tax) will unbalance their portfolio holdings and thus make land a more attractive investment. The resultant surge of the market toward land and out of produced capital mitigates the tax-induced drop in land prices and shifts some of the tax to other asset owners. (See Chapter 3.)

In the long run, of course, the capital stock is not fixed. People accumulate savings to finance their retirement consumption and to leave bequests. Long-term savers will react to the drop in their wealth caused by the tax-induced fall in land values by saving more in the form of produced capital. This build-up of capital will raise the gross rental value of land and lower the rate of interest, thus pushing up land prices and shifting part of the land tax to owners of produced capital. Feldstein is still pursuing the implications of his "new answer," but his logic should remind us of the danger of over-relying on abstract foundations as the basis for anything so pragmatic as a tax system.

Certainty

Aside from its application to a land tax, George's "certainty" canon sets forth simply and clearly what any citizen expects from a tax system. In explaining his principle he strikes chords that should resonate in any modern reader: "Taxes which lack the element of certainty tell most fearfully upon morals. Our revenue laws as a body might well be entitled, 'Acts to promote the corruption of public officials, to suppress honesty and encourage fraud, to set a premium upon perjury and the subornation of perjury, and to divorce the idea of law from the idea of justice' " (1879, rpt. 1960, p. 417). If this eloquent denunciation seems somehow to adumbrate the reaction which turned Proposition 13 into a national movement, it may also contain a warning that ought to be heeded concerning an even bigger issue, namely, the income tax.

Although many people cling confidently to the notion that the income tax is the fairest and most incorruptible of our taxes, there are rumblings in the distance that may foretell a rising tide of disillusionment with it. There is evidence that income tax evasion may not only be growing by leaps and bounds but also moving out of the shady fringes of our society and becoming a popular household sport. Cheating the government is apparently being regarded more as a virtue than as a vice by many citizens. This growing problem of the "subterranean economy" is fascinatingly described in a recent article by Peter M. Gutmann (1978, pp. 9–14).

Reading *Progress and Poverty* today, one can be caught up easily in George's persuasive eloquence. Like Keats listening to the nightingale, a reader finds himself carried away by the entrancing music of George's seductive and reassuring words — until, that is, the real world intrudes and brings him down with a thud. Just as the spell is broken for Keats by mention of the word "forlorn," George's soaring thought ends for the reader with a jarring return to the practical: "Were all taxes placed upon land values, irrespective of improvements, the scheme of taxation would be so simple and clear, and public attention would be so directed to it, that the valuation of taxation could and would be made with the same certainty that a real estate agent can determine the price a seller can get for a lot" (1879, rpt. 1960, p. 418). So it still comes down to that; the touchstone of value is inescapably the market price. Without the marketplace, price lacks certainty; without comparable sales, certainty in valuation is more hope than reality. The disappearance of vacant land, parking lots, or completely depreciated structures from a tax jurisdiction means the introduction of increasingly arbitrary variables.

It is in the discussion of his fourth canon that George applies his whole philosophy of value most directly to the tax issue. Ironically, in doing this he is brought into head-to-head combat with the very man whose exposition of tax principles he has been echoing — Adam Smith. His pure labor theory of value will not permit him to accept Smith's concept of taxation according to ability to pay and benefits received from government. Yet "equality" and/or "equity" are principles that neither can nor should be ignored. George is obliged to take the Scot to task for failing to see that "equality" in this matter refers not to how much a person earns but how the income is earned and how much it is needed. A taxpayer with a large family, George argues, needs more than a taxpayer with a small family; charging them the same tax would be an injustice. Furthermore, all income should not be considered equally taxable, since "Nature gives to labor; and to labor alone" (1879, rpt. 1960, p. 419). What one earns by his exertion is not comparable to the rent from land, which is Nature's gift to all mankind. Rising land values are windfalls provided by Nature, and they rightfully belong to the community.

One hundred years after George wrote this book it is appropriate to note that a tax system constructed on the basis of his concept of values has the potential of consolidating power in the hands of those who act for the "community." The more the tax base is taken out of the economic arena, i.e., the marketplace, and made a matter of political decision-making, i.e., how land is zoned and what it "ought to be" worth, the less objective, certain, and efficient the tax process is likely to be.

Alternative Tax Bases

However, the very existence of meetings that discuss the thinking of Henry George indicates that he offered the world something more than rhetoric. I should like to close with a few random thoughts triggered by George's eloquent and appealing equity arguments. He reminds us that a tax system must take other elements than market value into consideration. Indeed, one might argue that one reason our income tax has been less unpopular than the property tax is that it does make more concession to such inter-personal differences as size of family and use of resources. What one especially objects to in George is the simplistic nature of his economic arguments. If he were living today in our inflationary economy he might well be less concerned about the "monopolistic" character of land ownership and more concerned about the plight of individuals trying to keep up with the serious erosion of their assets by inflation, especially as they near retirement age. In today's world land is one of the few relatively inflation-proof investments available to the ordinary person. If people are seriously frustrated by the government's failure to keep the price level stable, as all the polls suggest they are, there is likely to be little appeal today to a special tax on land values or on land value increments.

One thing that ought to be kept clearly in mind about George is that he was writing about an undeveloped economy. The booming GNP and multi-billion dollar budgets of today's California were far in the future when George was formulating his ideas. The tax equity issues are very different for developed and undeveloped economies, and one needs only to look south of our border for an example of the latter.

This distinction was enunciated clearly nearly a century ago by no less an authority than Alfred Marshall, who (a year before his spirited debate with George at Oxford) delivered three lectures on *Progress and Poverty* while still at University College, Bristol. It is interesting that Marshall found George's work sufficiently challenging to devote so much attention to it, since it was ignored by most economists of the day. Marshall clearly was touched by George's concern for humanity, while also offended by his lack of historical perspective. Marshall wrestled with the question of land rights and weighed the justice of George's claim that land should be nationalized:

> Is it possible to undo a wrong done in distant ages, so that the punishment will fall on the right persons? If the original landholders had no good right to their title-deeds, are not an immense number of the present landholders the descendants of working men and others who have bought the title-deeds with the sweat of their brow? (1883, rpt. 1969, pp. 200–1).

Such considerations suggest for general tax policy purposes that a tax on land value increments would be more equitable than a land tax, except in undeveloped economies, where the effects of the two approaches would be similar.

Conclusion

Henry George's lasting attraction a century after his *magnum opus* was written must tell us something about the universality of his theme, if not about the perfect efficacy of his "sovereign remedy." In cases where land needed for production is neglected by heedless owners who lack either interest or incentive to develop it, the land tax could well provide an efficacious prod. It might also be a useful policy tool in the development of those new, ambiguously owned acres under the sea, where great new wealth in the form of mineral resources remains to be developed. If formulation of an international agreement is hampered, in part at least, by the lack of a general philosophical framework, future conferences could do far worse than to develop a manifesto from the theoretical base provided by Henry George.

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Henry George, U.S. land reformer and economist who in Progress and Poverty (1879) proposed the single tax: that the state tax away all economic rentâ€”the income from the use of bare land but not from improvementsâ€”and abolish all other taxes. Learn about this and his run for mayor of New York City.Â Leaving school before his 14th birthday, George worked for two years as a clerk in an importing house and then went to sea, sailing to Australia and India. Back in Philadelphia in 1856, he learned typesetting, and in 1857 he signed up as a steward on a lighthouse tender, the Shubruck, bound for service on the Pacific coast. He quit the ship in San Francisco to join the gold rush in Canada, where, however, he arrived too late. In 1858 he returned to California. For 100 years, driven by the winds of various political and social interests, Australia 'reviewed and reformed' its tax legislation. Fullarton studies that transformation. Fullarton's examination considers the oldest of tax planning entities-the British Trust ('received' in Australia at colonisation)-, the introduction of Australia's 'reformed' consumption tax-its VAT, referred to as Goods and Services Tax (GST) in Australia-, an analysis of tax avoidance schemes, and finally government taxation reform activities over the century. Fullarton notes that, j