INSTITUTE BRIEF

Volume 10, Number 35 December 2003

Site-Value Taxation: A Better Way to Tax

by David Hogberg

A just tax system should be applied fairly and avoid taxing productive activities. Professor Fred E. Foldvary proposes such a tax system in "Site-Value Taxation and the Rule of Law," a chapter in *Politics, Taxation, and the Rule of Law*, a new book from Public Interest Institute.

According to Professor Foldvary, site-value taxation "consists of basing public revenue on the value of real estate sites or the rental obtainable from such sites, excluding the value and rental of any improvements such as buildings."[1] Basically, a site-value tax is a property tax. However, it is a tax only on the actual land, and any revenue the land owner would receive from renting the land to others; it does not apply to improvements built on the land. So, if the land owner built an apartment building on his land, under a site-value tax he would not pay any property tax on the apartment or any rent he received from the apartment.

Professor Foldvary contends that site-value taxation has many advantages over our current tax system. For one, it is consistent with the rule of law. Rule of law means that the law must apply equally to all citizens, and the law must not be subject to the arbitrary whims of politicians. Our current tax system, based heavily on income and sales taxes, fails this test:

> In practice, both income and sales taxes are applied selectively, with some income and goods exempt and with widely differing tax rates. We get the well-known effect of government using taxation to influence behavior as well as for revenue, and also perhaps unintended consequences such as the marriage-penalty of taxing a married couple at a higher rate than two single persons having the same total income.[2]

Under site-value taxation, taxes would be based on land values, and all landowners would be subject to the same rate of taxation. Furthermore, since land, unlike income or sales, cannot be hidden, it would be much harder for taxpayers to cheat under such a system. Making it even harder to cheat would be the fact that assessment values would be a matter of public record.

Site-value taxation also avoids the problem of stifling production and growth that is inherent in other tax systems. Indeed, taxes often waste resources by increasing prices without increasing the amount of profit. Professor Foldvary offers the example of a shopkeeper whose taxes increase the cost of doing business sufficiently that it is no longer profitable to keep his shop open on Sundays. Not only does the shopkeeper lose out on the profit he would have otherwise made, but his workers lose out on the income they would have earned if the shop had been open on Sundays. The customers lose out as well, as they will have to travel longer distances to buy the product that they could have more conveniently purchased at the shop. Taxes create such waste because of the simple concept of supply and demand. Supply and demand are very sensitive to changes in price, and since taxes increase prices, they will reduce demand, and thereby reduce supply.

A Publication of:
Public Interest Institute *at* Iowa Wesleyan College
600 North Jackson Street
Mt. Pleasant, Iowa 52641-1328
Phone: 319-385-3462 Fax: 319-385-3799
E-Mail: public.interest.institute@limitedgovernment.org Web Site: www.limitedgovernment.org

However, a site-value tax avoids this problem because the supply of land is fixed. It cannot be increased with changes in demand. Thus, site-value taxes create very little waste. Indeed, a system of exclusively site-value taxation would eliminate all of the disincentives to creating new wealth that occur under a system of income, sales, and value-added taxes.

Another economic benefit of site-value taxation is that such a system would be far more stable. "In the U.S. there is a continuous pattern of tax cuts followed by tax-rate increases as well as an ad-hoc hodge-podge complex of federal, state, and local taxation."[3] The uncertainty and complexity of tax policy makes it more difficult for businesses to make long-term plans.

Professor Foldvary supports his economic argument with some empirical evidence. He notes that Japan in the latter half of the 19th Century and Taiwan after 1950 both adopted site-value systems, and both experienced high rates of economic growth as a result. "In Pennsylvania, cities may have split their property tax into separate rates for land and improvements, and where they have done so, those cities having lower rates on buildings have had greater growth compared to nearby cities of similar size."[4]

Professor Foldvary points to one last benefit of site-value taxation, that of making democracy more localized. Since a site-value tax is based on local property values, it would devolve power back to the local level and away from the Federal level. It would also break the power of the special interest groups that benefit from our current system of taxation. And that is what, sadly, makes a site-value system of taxation an improbable occurrence.

ENDNOTES:

[1]Fred E. Foldvary. "Site-Value Taxation and the Rule of Law," in *Politics, Taxation, and the Rule of Law: The Power to Tax in Constitutional Perspective*, Kluwer Academic Publishers, Boston, 2002, p.185.
[2]Ibid., p.195.
[3]Ibid., p.192.
[4]Ibid., p.194.

This Institute Brief is one in a series on the chapters of a recently-published book, POLITICS, TAXATION, AND THE RULE OF LAW*, edited by Dr. Don Racheter, President of Public Interest Institute, and Dr. Richard Wagner, Economics Professor at George Mason University and Chairman of the Institute's Academic Advisory Board.* POLITICS, TAXATION, AND THE RULE OF LAW *looks at the balance between providing government with the power to operate while preserving and protecting our rights of person and property.*

The author of this chapter of POLITICS, TAXATION, AND THE RULE OF LAW *is Fred Foldvary, Professor of Economics at Santa Clara University, Santa Clara, California.*

This summary of Professor Foldvary's chapter was written by David Hogberg, a Research Analyst with Public Interest Institute.

Permission to reprint or copy in whole or part is granted, provided a version of this credit line is used: "Reprinted by permission from INSTITUTE BRIEF, a publication of Public Interest Institute." The views expressed in this publication are those of the author and not necessarily those of Public Interest Institute. They are brought to you in the interest of a better-informed citizenry.