The Role of Ground Rent in Urban Decay and Revival

How to Revitalize a Failing City

By MASON GAFFNEY*

Introduction

YOU MAY THINK me an outlander but my parents were New Yorkers and never forgot it. One grandfather even went to St. John's, although not this St. John's—it's what they once called Fordham in the Bronx, now one of those dying cities we need to revive. He was to become a priest and lead the celibate life. As you see, he was not equal to the calling. His official obit tactfully says, "After leaving college he enlisted in the U.S. Navy," but Aunt Fan wrote privately, "Papa left Fordham before finishing and went to California where he taught school. Fordham required mostly brawn, he said." Violence here is not new.

He married late, so late a young man like me has a grandfather who served in the Big War. That is not remarkable except that means the Civil War. Ours is a family of long generations. My other grandfather, the Yankee Presbyterian, lived in Brooklyn Heights when that was a suburb for stockbrokers, and that goes way back too.

Now these old timers, to whom the past was only yesterday, spoke always of New York City as the center of civilization. It was a livable, optimistic place—a great, growing, vibrant, trend setting, prospering, cultural city. A little crooked, sure, and great-grandfather was probably no saint at paving streets for Tammany Hall. But it had a present and a future, a life and a soul, not like the dead-end hopeless despair of today's Bronx.

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Henry George

BUT WE'RE HERE to talk of the future. I'd like to see those good times and better ones come again, preferably without the graft. And we're here to review the ideas of another commuter between New York and California, Henry George, and how his ideas might be used to revive dead cities. Henry George was a journalist who taught himself economics. He had a flowing pen and a brilliant mind, and his book, *Progress and Poverty*, became and remains the all-time best seller in economics.

People remember him today not for the volume of his sales, but for the enduring quality of his ideas and proposals. The reform program he worked out combines the *magic of incentive* with the *magic of justice*. It comprises a plan not just to revitalize cities but to reunify society.

George's fans have boosted him for the Hall of Fame. It is ironic he never made it. Not that he would have cared, a stone face was not his style. The irony is that the Hall of Fame is now decaying and abandoned in the Bronx, a setting also decaying and abandoned for failure to use George's formula for keeping cities healthy and robust. The Hall of Fame in the Bronx exemplifies a malignant propensity to pour the national treasure into dead monuments while their living matrices starve, rot, and crumble. For further evidence, tour the purlieus of your state Capitol, contrasting the vulgar ostentation on the marbled side of the street with the squalid reality on the living side.

Dead and Dying Cities

WHAT ARE THESE moribund cities? Some extreme cases are East St. Louis, Camden, Benton Harbor (Michigan), Ford Heights (Illinois), along with Robbins, Harvey, Gary, and Newark.

But more commonly and generally, large parts of once vibrant cities are half dead, seriously blighted and trending downwards. One of these is the South Bronx, which New Yorkers know well enough to avoid knowing any better. In Milwaukee, it is the near north side, called locally the "inner core," a galloping blight whose area I have seen triple in the last 20 years while Milwaukee's population dropped 20 percent. In Chicago, it is South State Street, only a few blocks from the Madison Street crossing which for generations was the most valuable corner in the nation. In Tampa, it is Ybor City.

Note that blight is not restricted to stagnant or declining regions and cities. In booming Los Angeles, there is Watts. In nearby Riverside, California, one of the fastest growing cities in the nation, the central business district (CBD) is surrounded by blight which, among other things, frustrates years of subsidies aimed at reviving the moribund CBD itself.

But let us sound deeper to gauge the full mass of this iceberg. These extreme cases are not just anomalies. They are more than ghettoes and embarrassments; they are symptoms of systemic malfunction. They could be portents and symbols for the rest of the economy. Blight may be defined as a failure to maintain, to replace, and to renew the capital inherited from the past. Many studies of American industry indicate that it has this problem, compared with vigorous foreign competitors. In learning to cure blight, we may learn to restore the greatness and pride in this whole troubled nation.

Cities that Have Revived

THERE IS GOOD news too; some cities have risen from the grave. Indeed, all land development is resurrection in some sense; all land has been used before by someone for something from the beginning. Trace the history of any city lot, and you'll usually find there were several antecedent improvements, layered like the ruins of ancient Troy. It is a matter of making renewal happen faster and more widely, while we are still here to benefit.

Germany and Japan recovered from World War II with breathtaking speed. Atlanta even recovered from General Sherman too, although in its own courtly time. Chicago burned almost completely in 1871 leaving 90,000 people homeless, but recovered without breaking stride. San Francisco and Anchorage recovered from devastating earthquakes. Washington, D.C. recovered from the 14th Street riots and arson. The basics were right; the locations remained good. The disasters may even have helped by forcing the demolition of obsolescent capital and releasing land for rebuilding. "Instant urban renewal" is more than street jive; it can be true perception.

But some other revivals, less dramatic and publicized, are more impressive and relevant to us because they are revivals from normal decay and obsolescence, pushed along by good public policy, which we can analyze and replicate. There is Southfield, Michigan, bordering on Detroit and thriving and flourishing as fast as its parent central city is dying. There is Rosslyn, Virginia, just across the Potomac from D.C., a forest of high-rises that rose up while Washington was burning and derelict during the 1960s. There is Sacramento, California, whose once-depressing center has found new life. There is Pittsburgh, of grimy repute, recently named the most livable U.S. city. There are Hong Kong, Singapore, and Taipei, once best known as rather fetid ports of call, now three of the "Four Tigers" of Southeast Asia.

In all those modern success stories of economic and social revitalization, we find the hand of Henry George at work, if we seek out the local politics and policies. In Taipei, we learn they are guided by the philosophy of Dr. Sun Yat-Sen, and if we read Dr. Sun, we find he was an enthusiastic Georgist convert. In Pittsburgh, we find a "graded tax plan," applied, framed, and supported by something called The Henry George Foundation. Throughout Pennsylvania today, we now see several smaller cities emulating Pittsburgh's partial application of George's policies: Harrisburg, Scranton, McKeesport, New Castle, Washington, and Duquesne. *Fortune* reviewed their progress favorably in a 1983 article. Recently, steel-depressed Aliquippa signed on too, as did Clairton. These once declining cities bear close watching today as they bounce back.

Then there are cities of explosive growth after slow periods. These include Sydney and Johannesburg, both notable for their use of Georgist policies. Whatever their social faults, these two cities have burgeoned to become the economic capitals of their respective continents, an economic achievement hard to dismiss. There are several other good examples, like Nairobi in East Africa and Brisbane and Auckland in the Antipodes. Many cities of western Canada, including Edmonton, Saskatoon, Victoria, New

Westminster, and Vancouver, grew up with partial use of Georgist policies in the early 20th century. Less explicit application of Georgist policies was made informally (through assessment discrimination) by Seattle, Portland, San Diego, Houston, San Francisco, and many other growing western cities during the same period.

It is good to know degeneration and failure are not our predestined fate. We may choose them, but we may also choose renewal and success. It's a matter of attitude and know-how.

Why Cities Should Be Revived

SOME CITIES AND towns may and should be abandoned. Camps and towns around played-out mines are obvious examples. Some small farm towns and hamlets become redundant when roads let customers range farther and patronize the larger or better towns. Salvage what you can and move on.

Some would apply the same logic to all cities. Dead cities aren't lost, they say, but are just rebuilt elsewhere. They were cash cows that have been milked dry, meaning their depreciation allowances are reinvested on new frontiers and the people and vitality moved with the capital. That's a clever and important half-truth; but remember a half-truth is also half wrong. The basic original site stays put; land can't move. A lot of costly social capital, public and private, can't move either.

We have little room left for throwaway cities in this finite world. New natural sites aren't that common. There is only one water level route west along the Mohawk, only one Hudson Valley with only one mouth, and here New York City has stood for 350 years. We can't really afford to kiss off the Bronx and build a duplicate environment elsewhere. We can't rebuild the natural setting at all, and the sunken social capital is too costly: shipping, docks, rails, the New York Thruway, airports, streets, expressways, subways, water lines, power lines, sewer lines, gas lines, phone lines, churches, schools, bridges, tunnels, museums, Halls of Fame, universities . . . .

Of course, we can replace the Bronx out at the east end of the Long Island Expressway, but that means not only duplicating the micro-infrastructure but adding the Expressway and corresponding trunk lines for all the utilities, and paying the price or commuting in time, fuel, pollution, auto and tire purchases, repairs, paint jobs, insurance, gridlock, and traffic casualties. And then ultimately, when we tire of the new suburbs, where do we go next?

Look at the Earth from a lunarcraft photo. There is only so much, and we already have a big portion of the best temperate zone. This is our Promised Land. "Don't blow it," God keeps telling Israel in the Bible. "Don't think I'm giving you another Promised Land if you can't handle this one." It seems a reasonable attitude. Nor are other nations disposed to give up their crowded slices of this small, scarce Earth for us.

Furthermore, these blighted areas have high potential market values. Picture a topographic map of a city where the contour lines represent points, not of equal elevation but equal market value per square foot (psf). On this kind of topo map, the peaks, the Everests and McKinleys, are in the city retail centers where just one square foot rises to $2,000 (that's about $90 million per acre, and an acre is about 91 yards on a football gridiron). Land just a few miles or blocks away from such dizzying altitudes can hardly be worthless. Harlem is near Park Avenue; Watts is near Beverly Hills; South State Street is very near the Sears Tower. Newark is 15 minutes by train from Manhattan. Newark office rents are $25 psf per year. That is less, of course, than in Manhattan, but in Riverside, California we are throwing up offices to get rent of $12 psf per year while Newark stagnates.

The capital you invest that earns $25 psf is more productive, obviously, than that yielding $12 psf. I don't mean the capital in the floor atop the high-rise, because that is likely to cost $25 psf (in annualized terms) to build and operate. I mean the capital in the middle and bottom floors, which costs less to build but rents for as much and yields a surplus. To get more such middles and bottoms, and the corresponding surpluses, renew more land in those neglected areas of high potential like Newark. *Not* to renew those lands is to waste those potential surpluses. Each year's loss is lost forever, for the services of land perish with the passage of time.

Shall we treat the Bronx as a residence of last resort for people who can't afford anything decent? That's hardly necessary. To many people, cities are the Big Apple—desirable locations of positive values and strong magnetism. Rich foreigners come from around the world and pay top dollar to locate in Manhattan, not because they have to, but because they want to. So it is too with San Francisco, Miami Beach, Beverly Hills, Newport Beach, Cambridge, and Georgetown. If they want open country, there is plenty left in North Dakota, Texas, and Nevada—but they want cities.

Urban revival works best when a healthy piece remains on which to anchor new development. In the worst scenario, no such place remains, but even Camden has Campbell Soup. Newark has a great airport, a new Hartz Mountain Industrial Park, and the Prudential. Life is persistent and resilient. Vital seedlings keep sprouting; they only want sunshine, water, care, and cultivation.

The Urban Surplus

ONE OF THE reasons we remember Henry George was his pioneering work on cities, how they work and what good they do. Previous economists showed limited or no understanding of location value and its causes. Even Heinrich von Thunen, father of location theory, approached cities in an arid, antiseptic way that left out most of the sperm and egg, enzyme and ferment that today we call urban linkages and synergy. George was a mensch, like Holly Whyte or Jane Jacobs, seeing cities in intensely human, interactive terms.

George saw cities as foci of communication, cooperation, socialization, and exchange, which he considered the basis of civilization. He saw cities as the new frontier, an endless series of new frontiers, because the city as a whole enjoys increasing returns. The presence of people with good mutual access associating on equal terms expedites cooperation and specialization through the market. Multivariate interactions in cities are synergistic. Indeed, while each part—each parcel of land—is developed in the stage of decreasing returns, the composite city is generally in a stage of increasing returns, thanks to synergy. The whole is greater than the sum of its parts; and increases to the whole yield more than the sum of increases to the parts.

This synergistic surplus, says George, lodges in urban land rents. Thus he explained an outstanding phenomenon of his times, which other economists were overlooking completely: the unparalleled rise of urban rents and land prices, and the wealth and power of the owners.

To the investor in a building, it looks like this. The first $10,000 he spends yields him 30 percent or $3,000; but he pays ten percent interest or $1,000, leaving him a surplus of $2,000. To acquire the superior location that confers that surplus, he'll pay up to $2,000 annually, which means he'll pay up to $20,000 for title to the land (at ten percent, $20,000 will cost him $2,000/year).

Of course, the next $10,000 he spends may yield him more than ten percent, say 20 percent, conferring more surplus and adding more value to the land. But the idea is the same. He'll add to the building until the last unit of $10,000 yields him just ten percent, enough to pay interest and no more. (You have just taken a flying tour through the theory of diminishing marginal productivity.)

To understand ground rents and land prices is to understand cities; not to understand is to remain mired forever in confusion and fallacy, to be gulled and misled and bamboozled, which is, indeed and alas, the common lot of mankind. Let it not be yours.

These ground rents are annual, they continue forever, and they generally tend to rise. To buy title to land, therefore, people pay prices that look very high relative to current cash flow. In Riverside, California, a city of low density and 208,000 people, land prices go up to $18 per square foot. In San Francisco, a city of high density and 800,000 people, prices go up over $1,000 per square foot. In Manhattan, they go over $2,000. In Tokyo, probably the top of the line, one sale is reported at $25,000 per square foot.[1] An official agency has appraised the top value at $20,000 per square foot, although this may be puffed up. But $25,000 per square foot is high enough; urban land prices take your breath away.

Land prices vary extremely from city to city and block to block. The actual cost of building a square foot of floor space is fairly constant from place to place, but demand varies with location. A small rise of floor space rentals translates into a large percentage rise of ground rent and land price, because rent gets everything above what is required to operate and amortize the building.

Thus in Riverside at a small neighborhood mall, a floor space rental of $12 per square foot just pays for the building with only a little left over to pay for land, resulting in land prices of perhaps $5 to $8 per square foot. In Manhattan, rentals are triple or quadruple those in Riverside with all the surplus going to ground rent, resulting in land prices up to $2,000 per square foot, which are about 300 times higher than Riverside.

This is due to several factors. One is "leverage." Say the annualized costs of constructing and operating a building are $11 per square foot, whether in Riverside or Manhattan. That leaves $1 per square foot for ground rent in Riverside ($12–$11), and $37 per square foot in Manhattan ($48–$11). This factor alone makes Manhattan land worth 37 times Riverside land.

A second factor is intensity. At the higher level of floor rents in Manhattan, it pays to pack more floor space per acre, with high-rise buildings. Also, in Manhattan there is little need to provide workers and customers with parking space, while in Riverside six square feet of free parking are often required for each square foot of floor space.

Other factors are the greater pooling of demand in the bigger metropolis, which steadies its flow and gives more assurance of its continuation and predictability. The commercial vacancy rate in Riverside is pushing 30 percent.

In bigger cities at key locations, land prices are not just high per square foot; they are higher per capita than in small cities. Surprisingly, they are even higher relative to building values in spite of the high rise buildings. Remember each added floor until the top one adds more ground rent, because floor space rentals are more than enough to cover the added cost.

Urban land is also highly concentrated in ownership, meaning a handful of people and corporations own most of it. It is heavily favored by absentees of great wealth who want to diversify their holdings and acquire stable, secure wealth they can manage by remote control, so today a growing share of income property is held by aliens. Aliens even hold a good deal of residential property in selected communities of international jet-set ambiance and repute, places like Palm Beach, La Jolla, Greenwich, Belvedere, or Beverly Hills.

In comparing cities and neighborhoods, land prices are much more differentiated than other measures economists commonly cite. The median income in Upper East Side Manhattan is about eight times higher than that north of Central Park. But the price of land per square foot is probably 40 times higher. Margaret Reid presents many more contrasts of the same kind (Reid 1962); so does Harold Brodsky in his studies of Washington, D.C. (Brodsky:239).[2]

Sharing the Surplus

URBAN RENTS ARE a social surplus, not a payment in reward for anyone's making or supplying land. So others than the landowner have a claim. A good deal of American politics deals with how to assert that claim and share that surplus.

It seems a pleasant enough problem, cutting up a big pie. The ancient Chinese knew better: "It is easier to face a common enemy than share a surplus," Confucius said. The common ways of sharing this surplus are clumsy, divisive, and destructive. They bear some responsibility for dead cities. With too much quarreling and gouging over spoils, there are no more spoils to dispute. Macauley wrote nostalgically in *Lays of Ancient Rome*: "Then lands were fairly portioned; then spoils were fairly sold. The Romans were like brothers, in the brave days of old." The same might be said of New Englanders in the early 17th century, whose traditions we still honor in word and name. But we have come a long way from brotherhood. Let us see how spoils are shared now, and then how we might do better.

Looting and Graft

Looting is sharing by direct action. We had a bellyful of that in 1967, and its destructiveness needs no homily. Graft and patronage, the basis of ethnic-populist political machines, are more tempered kinds of looting which destroy incentives more quietly and insidiously. Featherbedding, stealing, parasitic behavior of all kinds, all cut into the surplus. The problem is they are blindly indiscriminate; they cut into productive incentives, too. But the more the surplus the more the temptation—the easier is the self-righteousness that rationalizes looting and graft.

Rent Control

Rent control shares the surplus with tenants. It is a tempting route and several cities follow it, including New York. Why not? Renters are the majority. Many landlords are rich and remote; they work through layers of faceless minions so you probably don't even know their names. The managers are tough and tight so you have a lot of abuse and negligence to avenge. Supply is inelastic, at least in the short run, so the owners can't cut and run. Poetic justice is served. But there are several spots on this policy.

- **Limited number of beneficiaries.** The original tenants carve out an equity in the landlord's estate, but the benefits spread no wider. Tenants may, and many do, sublet to others, becoming landlords themselves. Rent control is at best a zero-sum game among the few, not a social reform.
- **Lower incentive to maintain supply.** It becomes unattractive to build new rental units. At first, these are allowed higher rents but are vulnerable to future caps. So rent control is worse than a zero-sum game; it becomes negative-sum.

  What rent control confiscates is not just land-income, but building-income too. Land is fixed, but buildings need maintaining and replacing which they will not get if there is no return. Too, land can be reallocated to uncontrolled uses; we all know about condominiumization. The new wrinkle in Santa Monica is to buy a rent-controlled apartment building cheap and convert it to a single-family residence for the new owner.
- **Wasted space.** Tenants lose much incentive to economize on space, because it is underpriced to them. In the extreme, some tenants move away, but retain the apartment to use a few weeks of the year.
- **New class society.** Old renters become a privileged class vis-à-vis new ones in new units, which are temporarily uncontrolled or controlled at a higher level. With the lower new

supply and wasted space, uncontrolled rents are forced up above the free market level.

- **Owner/tenant clashes.** An owner's main goal under rent control is to evict and repossess. The resulting nastiness and intimidation have become routine, and the war stories legendary. In Tokyo, outright extortion and violence are frequent
- **Aborted incentive to maintain and improve.** Landlords lose all economic motive to serve and to maintain, let alone to improve. Tenants retaining precarious tenures have at most very limited motivation even to maintain, let alone improve property.
- **Dogged obstructionism.** A sitting tenant cannot gain by site renewal, but only faces eviction. Tenants therefore fight it every way they can. A class is created of dogged self-righteous obstructionists with a vested interest in the status quo, however obsolescent, however decayed, however inappropriate to the site.
- **Undertaxation.** The equity that tenants carve out of the landlord's estate has no market value, because it is inalienable (at least legally). Assessed values therefore drop, and tax yields drop correspondingly. The new privileged class not only gets preferential low rents, but also avoids contributing any share to support public services. The resulting higher tax burdens are dumped on others; the worsened public services are suffered by all.

Rent control is usually conceived of in terms of urban land, but the principle applies to other resources as well. I have personal familiarity with the perverse effects of capping the price of both water and energy.

I'm a small farmer with shares in a canal company, and the shares give me the right to receive water far below the market price but no right to sell my water. So my fellow shareholders and I do the only thing the law allows: we waste water and collectively create that chronic artificial crisis called the southern California water shortage. I'd be better off to have the state tax the water, raise the rates, and use the money to raise the salaries of—well, how about University of California professors?

The Federal Power Commission (now FERC) has long done the same thing with gas and earlier with oil, capping the field prices. Their Chief Economist, David Schwartz, opened my eyes to the moving spirit behind the policy when he joined a conference I sponsored in Vancouver. Our subject was how British Columbia (B.C.) might best collect rents from gas flowing from provincially owned wells. Dave Schwartz is a likable gentleman, selflessly dedicated to the public weal, but he grew impatient and finally blurted, "Lets not *collect* rent; let's cap the price and *eliminate* rent." That one foolish remark suddenly flashed more light onto 20 years of FPC regulation than tomes of NBER studies. They actually had so little understanding as *to believe* and act on that notion. By doing so they contrived to create, among other problems, the great gasoline shortage of the 1970s.

The rationale with housing, water, and energy all three is that these basics are too important to leave to the market and must be price-controlled. The result is to create systems of regulation much worse than anything a market could accomplish. Around 1973, there was also a great coffee crisis, a dearth of raisins, and even a crisis in toilet paper. These were too unimportant to regulate so their prices rose, demand fell, supply rose, and the crises quickly disappeared without a trace or a memory. Rent control ensures that we will not ever overcome the housing crisis so simply or at all.

"French Equity" (Equity in Kind)

Under the Code Napoleon, every French testator must divide his real estate equally among all children. There is no substituting money for land; the Code requires equity in kind, and nothing else will do. The resulting fine subdivision is called *morcellement,* and the Code demands it with no regard for efficiency. It goes further. Each heir must get an equal share of land of each quality: meadowlands, pastureland, woodland, etc. The even finer subdivision is called *parcellement,* which was once carried (like most human error) to absurd lengths.

Today, we approach "French Equity" indirectly and expensively. First, we distribute the land haphazardly, but *then* seek to make every parcel as good as every other. We do so by extending public utilities and roads to every parcel on the same terms, regardless of location and differential costs of service. A familiar example is the U.S. Postal Service, and it has given its name to this kind of pricing, called by economists "postage stamp pricing." Here are some quick examples.

- **B.C. Ferry Service.** This socialized system has two main lines to its Big Apple that make money: Vancouver-Victoria and Vancouver-Nanaimo. But the whole system hardly breaks even because there are some dozen lesser lines serving small islands and peninsulas. The worst of these costs $12 for every dollar of revenue. The losses are made up from the profits of the trunk lines. The generic name for that is *cross-subsidy.*
- **B.C. Hydro.** This socialized power system serves the entire province, an area so vast it exceeds those of California, Oregon, and Washington combined. Its rates are uniform throughout. Half of the people live in Vancouver at high density and are cheap to serve. A few live up north on the Yukon border where (I surmise) it costs several hundred dollars to earn one dollar of revenue. That is *cross-subsidy.*
- **Water and sewer service in Milwaukee County, Wisconsin.** Here the city investments have been captured, controlled, and milked by suburban interests, with a lot of help from the state legislature. Capacity in the city plants is taken up to serve the suburbs, and capital is poured into long interceptors (trunk lines) linking suburban land developments to city plants. That is *cross-subsidy* and has been called worse things.
- **College and university campuses.** The legislative ethic demands something for every electoral district. Not every assemblyman requires a college campus, for there are other prizes too, but the horse trading process seems to spawn too many. Just now we have eight UC Campuses, most of them with excess land, a few with excess floor space. Faced with rising enrollment, the preferred solution in Sacramento is not the lower-cost option of intensifying, improving, and staffing existing campuses, but the higher cost option of creating new ones. Each will enrich some influential land speculator and

tantalize a hundred others who are busy lobbying for the new spoils.

- **Water supply in California.** To summarize a complex tale, the low real cost of serving older settled areas is passed on to new settlements through an accounting device called "melding," a nice name for shutting your eyes and stirring all the accounts in the same pot. Melding passes through several levels: a state wholesaler serves the Metropolitan district, which serves local districts that serve cities. But the net result I have calculated is this: at the end of the line in Riverside, it costs society $1,800 to serve the marginal acre-foot (a unit of water) which sells for $20. That is *cross-subsidy.* It is worth fortunes to people developing land at the end of the line; the cost is spread over everyone else so they won't notice. Professors are supposed to keep quiet about it, but some of us never learn the rules.
- **Postal service.** How we love to dump on the postal service for raising rates and to moralize about the inefficiency of government. But do the harassed clerks really deserve the entire onus? Manhattan has 64,000 residents per square mile, plus the daytime population; Montana has 5.4 per square mile. It obviously costs a lot more to collect and deliver the mail in Montana. The main reason postal rates rise is because the whole U.S. urban population is spreading out more like Montana and less like Manhattan (which once had over 100,000 per square mile). Henry Schechter calls it the "cost-push of urban sprawl."

What's Wrong with "French Equity"?

There are two big problems with cross-subsidy as an approach to equity. First, it is not equitable; second, it is wasteful and inefficient.

The kind of equity achieved by regional cross-subsidies is not interpersonal, but inter-regional. It is something like Washington's programs of "foreign aid," which tax poor people in rich countries to aid rich people in poor countries. Some of the main beneficiaries are among the richest people and corporations in the country and world.

Here are a few who hold speculative land and enjoy subsidies on the growing fringes of southern California. Largest is probably The Irvine Company, owned by Donald Bren, among the 20 richest Americans on *Forbes'* latest list. This company holds some 70,000 acres in Orange County, including and surrounding Newport Beach, Irvine, and Corona del Mar. Others include Robert Campeau, who recently acquired Federated Department Stores; Chevron; Edward J. De Bartolo, also high on *Forbes'* list; Kaiser Development Bedford Properties; Connecticut General Life; Mobil; Lusk Realty; Bell Canada; Southern Pacific; Union Pacific; Cadillac Fairview (Olympia and York); Bank of Montreal; the Hunt oil family; and Newhall Land. The list goes on, but you see the point. Equity is not served by milking middle class neighborhoods to enrich owners like these. "Public works for private gain" is bad enough, but worse when the profiteers are already the richest.

How about efficiency? Subsidy creates waste in the amount of the subsidy, almost by definition. *Spread City,* by the New York Regional Plan Association, estimated that the social cost of creating one new lot at the metropolitan fringe is four times (4x) the value of the lot (and that is probably an underestimate, for the truth is so awful many readers would block it out or blame the messenger for the bad news). Why do people develop lots worth only one quarter of their cost? Because other people are paying the other three-quarters.

This process does transfer ground rent from areas of overcharge to areas of undercharge. But in the process, it simply destroys much of the ground rent, a process known to economists as "dissipation of rent." To spread the surplus, we lose much of it.

Being neither equitable nor efficient, has "French Equity" any kind of merit? Once it passed for a way to make jobs, in the salad days of J. M. Keynes, when he actually urged waste as a route to full employment. Those ideas are now dormant, but we still don't have the feel of it. If we had to fire a few teachers or policemen each time some city council yields to a major campaign donor and extends utilities to his raw acres, we would better sense the true cost of these "public works for private profit."

Sharing Surpluses Constructively

IT IS IN fact possible to mobilize the social rent surplus and put it to good use without waste. It is possible to create a just society of people unified and bound together in mutual satisfaction with the terms of their association, without contempt for their own government.

People do care about justice, always have and always will. They have funny ways of showing it sometimes: just now we're absorbing the "me generation," but this too shall pass. The problem is the older sharing-caring generations did some fuzzy thinking and foisted on us some clumsy, wasteful, and counter-productive ways to share and care, including substantial exploitation of the new generation they now brand as selfish. The "me generation" reacts against the stupidity and hypocrisy, not the noble impulse itself.

Rent will be shared, one way or another. Chicago economists preach that economists should only care about getting resources allocated efficiently to maximize the national product. "Entitlements" they say are arbitrary and don't much matter, just so they are clear and definite and everyone knows exactly what he owns and can trade it freely. In practice, that means leave them as they are today, whatever their origins. But life doesn't work that way. Eager supplicants swarm around rent like flies around fresh pie.

The key to renewing cities is shifting from *ob*structive ways of sharing rent, like rent control, and the *de*structive ways, like looting and cross-subsidy, to *con*structive ways.

George's Constructive Program

THIS BRINGS US to Henry George, for whom these lectures are named. He showed us how equity and efficiency go hand in hand: how to combine the *magic of justice* with the *magic of incentive.*

First, by George, equity need not be in kind, that's clumsy. Use the monetary mechanism, that's what it's for. If you and your brother and two cousins inherit a house sized for one family, you don't crowd all four families in; you sell and divide the money. Or one buys out the others. There is equity in money as well as real estate. Money is often better; you can reinvest it anywhere. It puts your house on a magic carpet to follow you around. Money is wonderful! (Just take care not to blow it.)

Second, by George, use the tax mechanism. Don't divide land into unusable morsels; don't shackle the market with rent controls; don't dissipate rent in cross-subsidies. But turn land over to the highest bidder, and tax ground rents to support government.

Taxing ground rent produces a range of social dividends. First, it overcomes the traditional trade-off between equity and efficiency by achieving both simultaneously. Second, it promotes renewal by permitting a reduction of taxes on buildings. Third, it encourages construction by reducing the liquidity constraints on developers of new buildings. Fourth, it produces synergistic effects (i.e., increases productivity) through positive spillover effects in the surrounding region. Fifth, it promotes better stewardship and more efficient land use by encouraging owner-occupancy. Sixth, it stimulates capital formation. Seventh, it encourages economy and discourages corruption in government.

Those are strong claims. Can economic policy do everything? No, but those are the things it can do, as I will explain more fully below. The basic impulse, however—the striving for justice and brotherhood and the sense of personal ethics—those come from within, from family, community, schools, and religion. So too does the sense of workmanship, the striving for excellence and competence, without which no system works.

The Primary Effect: Reconciles Efficiency and Equity

We've always heard that taxes destroy incentives. Economist Colin Clark said years back that the country would fall when taxes exceeded 25 percent of income. Arthur Laffer said tax yields would actually fall if rates rise, and rise if rates fall.

The news in Henry George is we can tax all the rent out of land and not one square foot will walk away. Nor will God switch off the Creation. Man creates capital by saving; some Other Force created land and sustains and serves it every day the sun rises, undeterred by taxes.

Nor will Georgist taxes leave owners sulking on their land, but the contrary. *Fortune* headlines them as "Higher Taxes that Promote Development" (Breckenfeld 1983). The tax is a fixed charge based on land's market value, derived in turn from its opportunity cost. The owner will use it harder and improve it more to meet the fixed tax. If he doesn't care to do that—if he has more than he can use—he will sell, releasing surplus land to meet the demands of others, of whom there are many with urgent needs and many more with enterprise wanting more space. Taxes stifle enterprise only if they increase with enterprise. Land taxes increase only with opportunity cost, which is independent of the enterprise of the individual owner. The only incentive this tax impairs is the incentive to withhold land from use.[3]

George's land tax promotes equity toward the landless in at least four ways: (1) it relieves them of taxes, to the extent that landowners pay more, (2) it supplies them with more goods and services as land is used better, (3) it offers them jobs producing those same goods and services, and incomes with which to buy these, and (4) it offers them a better chance to acquire land themselves, as surpluses are released to the market.

This is supply side economics with a real kick. It works through tax transformation rather than tax reduction—the total tax take may be raised or lowered as a separate issue. If desired, we can raise taxes and stimulate supply together; there is no hard choice to make between them.

So George's simple program not only reconciles efficiency and equity, it squares taxes and incentives. What more can a reasonable person demand of economic policy than to resolve these ancient basic standoffs that have confused and divided us, blocked understanding, and deadlocked constructive action for generations? It is an achievement on a par with resolving Evolution and Creation, except George's program is something we can do something about. We can use and implement it as quickly as we are willing to unclog the cerebral arteries and follow through with action.

Many people, it is true, are morbidly fascinated by deadlocks and standoffs and cling to them as old friends and comforters. They actually prefer irreconcilable disputes as cherished parlor games. It may ease the conscience to think justice must be sacrificed for efficiency, and schools starved and libraries closed to free up incentives, so nothing really can ever be done.

We all feel compassion by nature, but to survive and stay whole in this world of beggars and bandits, we learn to harden our hearts and cork it in. We learn to screen out evidence of suffering and injustice and rationalize what we cannot deny. This mindset, while understandable, is unaffordable in a period of dangerous national decline and growing division between haves and have-nots. Corking in feelings is hard on a person, too. There is relief and satisfaction in venting compassion via support of constructive public policies.

The Double Effect: Permits Untaxing of Building

The counterpart of sharing rent through taxation is to untax things people do and make, like buildings. This doubles the incentive effect. If the land tax is the stick, untaxing buildings is the corresponding carrot, and George's program is to make both of them larger.

Every lot with an old building is pressed between that building, the "Defender," and a potential replacement, the "Challenger." The trouble with taxing buildings is that it stacks the fight; it rigs the score against the Challenger. Say the lot-cum-Defender is worth $100K and the Challenger would cost $500K to build. Challenger cash flow must exceed Defender cash flow by enough to pay off the $500K *plus* added taxes based on it. If the tax rate is high, that will stifle new investment as thoroughly as a communist coup.

The Georgist tax by contrast is impartial between Defender and Challenger, and lets the market decide. In Milwaukee in 1965, after a long detailed study, I found switching to the George program would let 30 percent of the city be renewed forthwith, simply by untaxing Challengers vis-à-vis Defenders. (The sad news is the mayor went the other way, so Milwaukee has lost 20 percent of its people and more of its wealth and is a sick city today.)

The Triple Effect: Enhances Flow of Credit

Most buildings when new have to surmount a liquidity crisis. Almost every one is built on credit with a small equity and takes a while to yield cash. During this critical period, builders need all the help they can get.

The property tax on buildings is a maximum during this crisis. The timing is such as to maximize the damage for any given tax yield over time. Now, of course, a building uses public services and something must be taxed to pay, but new buildings in older cities nearly always pay for more than they receive, while old ones receive more than they pay for. Think of building taxes as a kind of forced loan from the builder to the treasury, to be recovered down the line when buildings are older. But what could be more counterproductive than forcing a loan from a person passing through a credit crisis already?

The Georgist tax works the other way. It spares the builder when he needs it, and rises slowly under him over time as the site ripens to its next best use.

The Quadruple Effect: Produces Regional Spillovers

Urban blight is cumulative and self-reinforcing; blighted buildings cast a pall on land around them, discourage upkeep, and stifle renewal. Whatever slows renewal of one site therefore slows the neighborhood, which reflects back blight to the first—a vicious downward spiral.

Conversely, new buildings help stimulate renewal around them. There are exceptions, I know. Some new buildings, especially banks and corporate headquarters, sterilize a block with blank walls. I will not defend that, but the exception is not the rule; the abuse is not the precept. The rule is new buildings draw tenants from old ones and weaken other Defenders, so other owners have to renew, too. When they do, where better but next to the newest, hottest building? So renewal is cumulative, just like blight, only upwards in a benign spiral.

This competition for sites raises the tax base—not from buildings but from land prices derived from ground rents. Using the higher base, the city can improve public services, if needed, but without taxing any building, without scaring away any generators of fiscal surpluses. In this scenario, buildings raise the tax base indirectly by raising the value of land around them.

The Quintuple Effect: Reunites Ownership and Occupancy

Riverside, California built itself a lovely downtown pedestrian mall, back when that was in vogue, and has been sorry ever since. Nothing worked out, retailers deserted, and half the stores are empty. Recently I asked the developer of Tyler Mall, a success, why he thought downtown failed. I got the answer in two words: "absentee ownership." I should have known; I've preached it for years.

An agricultural adviser in Fresno once told an impressionable boy, "The best dressing for soil is the owner's shadow, applied daily." In town they say, "Who's keeping the store?" Absentees aren't the only negligent owners, nor are they all bad. Torpid owners are the problem, and they come in many forms. Basically to make a city go, you want to be rid of owners who see real estate mainly as a cash cow for their retirement and replace them with owners who see it as a vehicle for their enterprise, who apply their shadows daily. Those shadows will also follow them into local civic clubs and enterprising downtown and neighborhood associations for making joint improvements.

This is a surprisingly delicate area. Walter Goldschmidt was persecuted and maligned for his classic *Small Business and the Community,* 1946 (republished in his *As You Sow,* 1947). His sponsor, the Bureau of Agricultural Economics, fared even worse; it was terminated with extreme prejudice. But he documents the points abundantly by contrasting Arvin, Dinuba and Wasco, California.

It is the surplus in land use that attracts outside buyers. Absentees are redundant parties in production, but often top bidders for pure ownership; that is the legal privilege of receiving ground rents plus unearned increments that accrue over time. Georgist taxation spares the rewards of enterprise and cuts most directly into those "runs of free income" (as Veblen called them in *Absentee Ownership*), which attract absentee owners. For that reason, it slowly makes the market transfer ownership from absentees to occupants and managers on the spot, with all the good community effects that must follow. In a period of rising concern over alien takeovers of U.S. real estate, these points merit focused attention.

The Sextuple Effect: Increases Capital Formation

Untaxing buildings obviously draws in outside capital, which is good but is not capital formation to the whole economy. In Keynesian models, however, reducing taxes on new capital raises the rate of return after taxes ("marginal efficiency of capital") and does create new capital. In supply side models, it is more important to increase saving. Land taxation helps here, too.

Land taxation, if vigorously applied, tends to reduce the investment value of land through a process called "tax capitalization." There is a diminishing marginal utility of savings to any wealth holder, meaning the more you have, the less you need more. With land devalued, those needing wealth seek substitute assets to replace land in their portfolios. To acquire those additional assets, they must save more and invest the savings in real new capital, rather than land.

The Septuple Effect: Greater Economy and Less Corruption in Government

Georgist taxation tends to reduce the need for public spending in at least two obvious ways. One is to increase job opportunities, which in turn reduces welfare spending. The other is to obviate much of urban sprawl with its costly, wasteful cross-subsidies.

In the longer run, it seems reasonable to expect that more genuine productive job opportunities at home would reduce the pressures for military spending, at least those portions which are strictly boondoggling of a make-jobs nature.

There are city councils and councilpersons who can botch up and corrupt the best system ever blueprinted. But the Georgist program may even help straighten them out. Lincoln Steffens taught us that the troublemaker in Eden was not Eve, nor even the serpent, but . . . the apple! The apples of discord that corrupt city councils are unearned increments to land value, which they create or deny with every decision about extending sewers or changing zoning. Georgist taxation dehydrates those apples by attaching higher tax liabilities to each unearned increment.

Does Renewal Destroy Housing for the Poor?

SOME PEOPLE, RECOGNIZING that George's idea of taxing land values will be effective, fear that it will be too effective. They are reminded of earlier programs of urban revitalization that made victims of those they were supposed to help.

"Slum clearance" in the 1950s had a negative cast, with a name catered solely for middle class consumption. Reuse of cleared land was often at lower density, inevitably throwing an increment of unhoused people on the private market. Federal "Urban Renewal" in the 1960s was better named, but the actual emphasis was all on clearing, not rebuilding. The inventory of cleared, unrebuilt land under the Federal program grew vaster each year. "Bombing Out" and "Negro Removal," the cynics' cracks, were on the mark, although blacks were not by any means the only evictees. Any talk now of demolition and renewal evokes the specters of those tragic, cruel, wasteful public programs.

But George's program *begins* with fostering renewal and intensive use. Clearance is involved only as needed to serve renewal, never a goal in itself. The first land taken would generally be vacant or unused, such as boarded-up buildings. New buildings would draw renters and buyers from old ones, releasing more space. The idea and the impact are to increase supply of rentable and salable floor space. There would also be more stores with more competition in selling, and more employers with more competition in hiring.

How do we know there would be an aggregate increase of supply? Higher density is one test. Untaxing buildings fosters higher density, because density, exemplified by high buildings, is the substitution of capital for land. Untaxing capital obviously makes that more economical.

Higher quality is the other test. The richer the new tenants or buyers, the more space they release elsewhere when they move to new quarters. Now this is the hardest point to see and accept, if you are poor or an advocate for the poor. There will always be specific cases where the rich bump the poor. There is a certain mindset that locks onto such specific cases and makes up contemptuous names like "trickle down" to dismiss effects on the aggregate market. But the aggregate is what should concern us. If we mobilize local tenants to fight new building, we are marshaling a minority with a particular vested interest to fight against the interests of the majority of the poor, and everyone. We will spend our lives straining at gnats and swallowing camels. For the plain fact is that building new homes for the rich, the ones who can afford new homes, is what releases useable space for everyone else.

There are three kinds of slums. Only one kind, the narrowest of the three, is likely to witness evictions for the rich. This is the slum on high-valued land. These slums develop in the van of expanding commerce or high rise apartments, where landowners neglect their buildings because they expect to demolish them soon. These areas are limited. The second kind is on bad land, which will stay bad.

The third and most common is on good land covered with old buildings, which have filtered down to people who generate bad neighborhood effects. Many of these units go vacant. The land value is low. The market will never renew these slums at one stroke, but by nibbling at their fringes. But as it nibbles incrementally in, if it does, it unavoidably creates more space than it consumes, raising the aggregate supply.

Another fear for the poor is gentrification. But this, by definition, is where new gentry displace the poor without renewal, occupying the same old buildings. This is one result of not renewing; renewal as such is innocent. It seems a bit carping to criticize people for maintaining and restoring old buildings. The alternative may be viewed in many ungentrified neighborhoods where buildings simply go out of use, sheltering no one.

An example of what happens when renewal does not occur is Camden, New Jersey, which has the highest tax rate in the state. It's a depressant now and a vicious circle as the high rate drives away capital and further erodes the depleted tax base. But what if the tax were on just land value? The depressant would become a stimulant, the drag a motor, by the simple magic of converting a variable charge into a fixed, unavoidable one. So it is with most other cities in need of renewal, which today look vainly to Washington for salvation and redemption. They do need enabling legislation from their states, on the Pennsylvania model, but given that, they can save themselves. They'd better; no one else is going to do it for them.

But the ultimate end of Georgist policy is to be viewed in terms of the nation, not just single cities. The idea is to pit cities against each other to attract people. Nothing is better for people than to be competed for. It raises their bargaining power as tenants, buyers, and workers.

A Summary of Reconciliations

GEORGIST POLICY HAS been shown as a means to revive dying cities, and in the process to reconcile equity and efficiency, to reconcile supply side economics with taxation, and to reconcile capital formation with taxation of the rich. It can be seen as a means of harmonizing collectivism and individualism, in the most constructive possible ways. I know of no other program whose proponents even make such claims, let alone substantiate them. As you issue forth with cap and gown into a world that has already priced you out of the real estate market, you will find George's program worth your intense study and strong support.

Notes

1. *Editor's note:* This figure comes from 1988, before the Japanese economy—and its land values—plummeted.
2. See also Schwab (1998).
3. A primary concern expressed by environmentalists about land value taxation is that it will cause "overdevelopment," particularly by forcing farmers to sell to developers at the urban fringe. The opposite is the case. The tax encourages more intensive development of the sites with greatest value, leaving sites of lesser value (those at the urban fringe) undisturbed. Nevertheless, if citizens are not persuaded that this principle will be effective in stemming sprawl, it is possible to draw an urban growth

boundary, and apply the land tax more heavily inside it than outside. In a perfect market, with perfect planning of public works, this might not be necessary; but in this imperfect world it may be the best device to recover from the present aggravated condition of urban sprawl.