To Heads of State regarding Financing Climate Initiatives and Financing for Development Post-2015

Submitted by the Commons Cluster.

COMMONS RENT PUBLIC FINANCE for CLIMATE MITIGATION AND SUSTAINABLE DEVELOPMENT

Establishing public finance and tax systems based on resource rent and land value taxation can mitigate climate change. Climate finance and sustainable development finance are strongly interrelated and both can be best addressed with this approach while lowering or entirely eliminating taxes on work and production.

The state of the earth now requires that the costs of industrial production and human commercial activity no longer be externalized onto the local to global commons. The policy of charging fees for use of land sites (aka land value taxation) can be extended to include other natural resources in the form of “green” taxes. To mitigate emissions into air, water and soil, fees can be imposed according to intensity of use.

Ecological economics research and data indicate that true cost pricing of natural resource use and capturing that cost via ecotaxes and resource rental charges would be sufficient to eliminate taxes on labour and productive, sustainable capital. Thus full incentives are harnessed to address climate change (tax "bads") and encourage green technology (untax "goods").

<u>Taxing carbon while untaxing renewable energy technology can be a major driver in the mitigation of climate change</u>. Socializing commons rent while untaxing production best enables affordable housing for all, capacity to finance infrastructure, poverty eradication and infill development for compact, walkable and energy efficient, breathable and livable cities. This public finance approach mobilizes both public and private sector resources by properly harnessing the incentives of taxation policy.

<u>There are several ways that this public finance approach can mitigate climate change</u>:

Tax pollution - Governments should directly levy carbon and other pollution charges and use these funds to develop renewable energy systems and to launch campaigns to “buy and invest in clean and green” technologies and products. We support Jeffrey Sachs call for a global carbon tax. See: www.devex.com/news/for-jeffrey-sachs-100b-climate-finance-target-has-2-major-problems-86658

Decrease or eliminate wage taxes - Because energy taxes can be regressive, combine them with tax decreases on wage incomes or ideally, eliminate wage taxes altogether.

Reduce or ideally eliminate taxes on buildings - This along with full land value capture will encourage infill development and more compact cities that make energy efficient use of public transportation and infrastructure while discouraging wasteful sprawl development patterns.

Curb profiteering and speculation in land and natural resources – When investment of funds in these non-productive activities is discouraged via land value capture more funds are available for investing in new "green energy" technologies and environmentally sensitive design and production.

Encourage more labor intensive, organic agriculture, rather than oil intensive agribusiness - Land value capture will help keep land affordable for small farm agriculture and better reward farmers for their labor when their tax burden is decreased or eliminated. This form of agriculture also encourages healthy communities and decentralized, local based economies, decreasing the necessity for people to drive long distances to work or for food to be transported long distances to markets.

<u>Land value taxation combined with removal of taxes on labor and production harnesses incentives for intensive organic agriculture by:</u>

1. Discouraging speculation in land
2. Reducing the price of land to equate with its value for production
3. Enabling new entrants to more easily obtain land
4. Limiting farm sizes to those of the most productive units
5. Enabling the reduction of taxation on earnings and capital
6. Reducing interest paynents as land became more affordable
7. Preventing rural depopulation
8. Discouraging urban sprawl onto farm land
9. Encouraging owner-occupation rather than absentee ownership
10. Promoting more responsible use of land.

Commons Rent and Rent-Seeking

"Commons Rent" is a useful term to describe the surplus value or unearned income that is created by society as a whole and is reflected in land prices. The value of Commons Rent, 25 to 30% of GDP in many countries, increases as development proceeds. However, when the commons rent is privatized, as it is in most cities and countries, land becomes the focus of rent--seeking, land grabbing and other land speculation activities. Land prices rise faster than the return to wages.

This causes market malfunctions and distortions as inequality grows and public sector needs are not well met. To remedy this problem we urge the implementation of a public finance policy approach that captures the commons rent via land value taxation, land value capture, and/or land lease fees. Part and parcel of this public finance policy is to reduce or eliminate taxes on goods and services. In other words, do not tax labor if we need jobs, do not tax houses if we need housing, and do not tax food production if we need food.

Rent-seeking and inequality go hand in hand, as Joseph Stiglitz so clearly points out:

> In their simplest form, rents are nothing more than re-distributions from one part of society to the rent seekers. Much of the inequality in our economy has been the result of rent seeking, because, to a significant degree, rent seeking re-distributes money from those at the bottom to those at the top…. rent seeking distorts resource allocations and makes the economy weaker. It is a centripetal force: the rewards of rent seeking become so outsized that more and more energy is directed toward it, at the expense of everything else. – Joseph E. Stiglitz, Nobel Memorial Prize in Economics, 2001. (The 1 Percent's Problem. *Vanity Fair*. May 31, 2012).

Commons Rent Public Finance and Urban Planning for Green Spaces and Walkable Cities

Taxation can both create and destroy wealth as well as direct the location of wealth creation. For instance, a tax on windows was used in Great Britain from 1696 until 1851. As a result, the poorer people bricked or boarded up their windows while the very rich built mansions with an excessive number of windows to ostentatiously display their wealth.

A commons rent approach harnesses economic incentives in ways that facilitate the goals of urban planning. There are compelling reasons, such as efficient and equitable utilization of infrastructure, to first develop the highest value land found near population centers. Untaxing improvements means that a developer or investor desiring these sites will not be penalized with a tax increase as a result of improvements made. But doing little or nothing on a site of high value is discouraged when the full commons rent of land is collected. Thus downtown land sites are put to their highest and best use.

Growth then radiates smoothly from more intensive use in the urban centers to rural areas without pockets of vacant or poorly utilized land in between. Urban sprawl is curtailed and rural land is more readily retained in its natural state, available for parks and nature preserves. There is also less pressure to build on agricultural land near urban areas.

Rational and balanced development which curbs sprawl thus also makes better use of existing infrastructure of transportation, utilities, fire and police protection and other public services. All of these factors increase social cohesion

Land for parks and green spaces in downtown areas is facilitated in at three least ways with a commons rent public finance approach: (1) land is more affordable for public purchase for public spaces because of the elimination of the land price bubble due to land hoarding, under-utilization and land speculation; (2) because parks and green spaces are desirable public goods, living close to them enhances land values in their vicinity, thus bringing more revenue into the public coffer; and (3) capturing full land rent yields a strong base of public revenue to fund upkeep and protective services for parks and green spaces.

Financing Infrastructure

The problem with "standard tax" regimes is that taxes fall more heavily on income to labor and productive capital and very little or not at all on the increase of surface land rent that invariably is the result of infrastructure improvements. <u>The basis of finance for infrastructure maintenance should be via the capture by public authorities, for public benefit, of the economic rent from the areas serviced by the infrastructure, not by burdening labor and production</u>.

It has been well documented that infrastructure can be adequately financed in total from the increase of land rent resulting from the infrastructure. Joseph Stiglitiz noted this in his analysis, often referred to as the *Henry*

George Theorem (HGT), that under certain conditions, spending by the government on public goods will increase aggregate land rents by an equal amount. In fact, we now know that land rent uplift from infrastructure investment can be significantly greater than the cost.

This is an astounding assertion. Why tax labor and productive capital when land rent can pay for necessary public goods and procure a number of other benefits as well? University of California, Riverside professor Mason Gaffney has identified how conventional data relied upon by most economists hides or understates land rents and values giving the false impression that the tax capacity is low.

Gaffney describes 16 elements of land's taxable capacity that are either trivialized or omitted from the National Income and Products Account (NIPA) and other data sources. "Any one of these 16 elements indicates a much higher land tax base than economists commonly recognize today," says Gaffney. "Keepers of the national accounts keep deluding us that rent and value are trivial."

Stating that the HGT in static models says that when a city has an optimal population size, the aggregate urban differential land rents can cover the costs of pure public goods, Professor Shihe Fe at Boston College questioned if this would hold for dynamic contexts. His study concluded that it does, revealing that the "present value of urban differential land rents over all time periods equals the present value of public goods expenditure over all time periods."

<u>In fact, land rent uplift from public infrastructure investment can be significantly greater than the cost</u>.

For example, calculations of the total land value increase that arose within a radius of only 1,000 yards of each of London's Jubilee Line Extension (JLE) underground train line stations built in the mid-1990s show that these land values have increased by 13 billion British pounds (US$22.8 billion), while the construction costs of the JLE were 3.5 billion British pounds (US$6.13 billion).

An independent study carried out for Transport for London estimated that between 1992 and 2002, near two of the 11 new stations, Southwark and Canary Wharf, the JLE caused land values to rise by 2.8 billion British pounds (US$4.9 billion).

This means that the UK government could have built the JLE at no cost to the public treasury if they had just chosen to collect less than one-third of the increased land values arising from the new transit line. Instead, with the exception of two modest private sector contributions, the funding for the JLE came from the government's budget, drawing from income taxes and other traditional revenue sources.

Land rent focused public finance can help assure that private-sector financing will be directed to the provisioning of infrastructure and needed capitalization and not towards highly detrimental projects that may be a cover for land speculation. Thus our strong recommendation regarding the World Bank's interest in *reviewing conditions to establish a Global Infrastructure Facility* is that any source of infrastructure funding, be it ODA, diaspora funds, private investments, or foundations be conditional on the benefactor city or country establishing a land value taxation / commons rent form of public finance.

The World Banks *Financing Development Post-2015* document states:

> With their growing assets under management and their ability to provide long-term finance, institutional investors, such as pension funds, insurance companies, mutual funds, or sovereign wealth funds have potential as pools of non-bank capital for emerging markets infrastructure…. it is estimated that less than 1 percent of institutional investor's portfolios are allocated to infrastructure investments.

One reason that there is such a low amount of institutional investors' portfolios allocated to infrastructure investments is that it is so much easier to search the world to invest in real estate than it is to take the time and attention to find solid proposals for infrastructure investment. This rent-seeking phenomenon is well explained by Joseph Stiglitz in his book The Price of Inequality.

Mobilizing Domestic Resources for Financing Sustainable Development and Mitigating Climate Change

The United Nations' development agenda beyond 2015 calls for a renewed global partnership to foster a number of transformative and mutually reinforcing actions that apply to all countries, including: poverty eradication, tackling exclusion and inequality, women and girls' empowerment, the provision of quality education and lifelong learning, better health, climate change mitigation and adaptation, managing environmental challenges, inclusive and sustainable growth and decent employment, the end of hunger and malnutrition, addressing demographic challenges, enhancing the positive contribution of migrants, meeting the challenges of urbanization, peace building and effective governance.

A properly established system of public finance is essential for making solid and stable progress in addressing each and every one of these concerns.

Section 2 of the World Bank's Financing for Development document focuses on how best to support developing countries in mobilizing domestic resources for development, by boosting taxation capacity, harnessing natural resource revenue. Section 5 explores a range of emerging and innovative sources of finance and the role an inclusive financial system can play to promote development.

Similarly *The Gates Report* says:

> Domestic resources will be the largest source of funds for development…it is essential that domestic resources be mobilized on a larger scale … transparency requirements…bolstering investment in infrastructure, drawing on the potential of the private sector, sovereign wealth funds…supports explicit taxing of carbon, including shipping and aviation fuels…

A correctly harnessed taxation system can mobilize BOTH domestic private AND public resources. Removing taxes that burden labor and production boosts the capacity of both. Removing taxes on labor increases purchasing capacity while removing taxes on production boosts productive capacity of the private sector. Together both effective demand and supply are enhanced.

The WB document points out that low *tax-to-GDP ratios are* "exacerbated by high levels of capital flight and limited capacity to collect revenues from multinationals… Broadening the tax based, improving tax administration, and closing loopholes could make a significant difference in lower-income countries…."

However, broadening the tax base to include taxation of wage income and production of goods and services depresses the capacity of both. We need instead to focus taxation on the "unearned income" (Adam Smith's term) and "surplus value" (Karl Marx term) that accrues to the gifts of nature (land and natural resources) - a socially generated value that increases as development proceeds. In other words, commons rent is the proper source of public finance.

Note that Paul Collier is calling for the socialization of land rent. Collier is Professor of Economics and Director of the Centre for the Study of African Economies at Oxford University. He is also advisor to the Strategy and Policy Department of the IMF and advisor to the Africa Region of the World Bank. Collier strongly stated this view during his keynote address to the 2012 World Bank Land and Poverty Conference year. His paper containing his views that rent should be socialized was also published in 2012.
Collier is concerned that much of the current acquisition of land in Africa is for purposes of speculation rather than investment for genuine development projects. In his speech he said:

> Density is valuable and that value is reflected in the price of land. The taxation of land appreciation offers huge scope for financing the cost of urban infrastructure. But the default option is for the costs of urbanization to be socialized, while the benefits are captured by private land owners. He asks "to whom should that value accrue?" and answers his own question with a clear response: "That gain should be socialized."

Sovereign wealth funds established in, for and by low income countries, correctly constituted as detailed elsewhere in this commentary, can also be included as an additional way to "mobilize domestic resources." This can be an excellent source of infrastructure finance AS LONG AS this is concurrent with the establishment of a surface land rent capture / land value tax system. Otherwise, the benefits of infrastructure development will be counter-balanced by privatized escalating land prices to the detriment of the capacity of market forces that could otherwise be fully able to procure additional basic needs such as affordable housing.

Affordable Housing for All

One of the great challenges throughout the world is the need for affordable housing for all. There is every indication that the private sector can better meet this need when those who need housing have greater capacity to purchase housing (effective demand) and the production of housing is no taxed (enabling enhanced supply.)

An additional and crucial key to housing affordability is land access and affordability. When the land rent of surface land, calculated as a percentage of land price, is captured via an annual or semi-annual land value tax or site fee, then there is no incentive for land speculation or hoarding and land retains affordability for needed uses.

Best Practices for Sovereign Wealth Funds

Revenues from non-renewable resources should be reinvested so as to build long-term wealth and to contribute to post-2015 Development.

Public officials and citizens alike need more awareness of best practice models concerning how to establish sovereign wealth funds for the capture and equitable distributionof natural resource rents. The Alaska Permanent Fund (APF) has many best practice features that should be better known. Additionally, the APF is nearly the only sovereign wealth fund that distributes direct citizen dividends. The annual dividends are credited by many as the key reason why the state of Alaska is the least unequal of all the states in the United States.

A two book series on the APF was published in 2012 by Palgrave MacMillan contains a thorough exposition of the APF Dividend Program, the best analysis to date. The second book titled Exporting the Alaska Model – Adapting the Permanent Fund Dividend for Reform around the World contains a number of recommendations for changes that could be made to the APF that can serve as a model for new sovereign wealth funds or the improvement of current ones. Of particular relevance titled "Assessing the Strengths and Shortcomings of the Alaska Model in Advance of Export.

Please note the analysis of the Alaska Permanent Fund Dividend Program for details on proposed best practices for the investment of revenues from non-renewable resources.

Additionally, subsidy reform is one of the main areas in which public resources can be redirected to more effective uses. The pre-tax subsidies of billions of dollars for petroleum products, electricity, natural gas and coal should be removed. Full public capture of land and resource rent could potentially yield sufficient funds so as to enable distribution of citizen dividends.

Fiscal Transparency

Im*proved fiscal transparency…can have a positive impact on government budgets in several ways. Transparency can facilitate taxpayer compliance and willingness to pay and contribute to a better investment climate.*

Again in reference to the *Alaska Permanent Fund*, this sovereign wealth fund has a high degree of transparency as well as responsiveness to the citizenry and should be better acknowledged as such. Regarding transparency in land tenure and taxation, highly detailed GIS "land value maps" posted on the internet as well as search engines attached to website enabling citizens to access information regarding land tenure and taxation are driving the movements emerging for a land value taxation form of public finance.

Multinationals are involved in many activities in developing countries in addition to resource extraction. These activities are located on surface land, for example agribusiness and fast-food restaurants. While it is challenging to redistribute wealth that has been deposited in off-shore cash accounts and other tax shelters, it is much more difficult to hide the use of and value of surface land and thus much easier to administrator taxation on the value of land sites. For more on this see the *Follow the Clown* section in this article on Making Money in Real Estate Speculation.

The Problem with Philanthropy

Philanthropy has been growing fast, with more than 100 billionaires meeting Bill Gate's challenge to leave at least half of their wealth to charity over time.

There must be great caution taken with charitable contributions as a source of development financing because of the underlying shortcomings of the neo-liberal economic paradigm. Even when successful, charitable projects increase land values and if the land rent generated is not recycled back to benefit everyone this simply results in higher land prices and thus higher costs of housing and other basic needs. The paradigm utilized should be the classical or better still the "geo-classical" model that recognizes that the right to private property comes with the responsibility to pay to society the rent of land sites, successful examples of which are being noted in this commentary. For more on the debate about philanthropy see Peter Buffett's (son of Warren) article on the Charitable Industrial Complex.

We would recommend that foundations establish revolving loan funds that will be repaid via public land rent capture. This approach can kick start sustainable development with infrastructure funding, enable a replenished source of funding for infrastructure for an increasing number of localities, and at the same time establish an efficient, sufficient and transparent public finance system that will also enable the upkeep and maintenance of the infrastructure. If cities are to be sustainable they need to mobilize domestic resources with a sustainable source of public funding. Land value taxation / aka socializing land rent is by far the best approach.

Although the *Gates Report* and other sections of the F4D Post-2015 recommend carbon and other taxes drawn from commons domains including extractive resource taxes, there is no mention anywhere in F4D of the importance of getting all the signals right by untaxing labor and production and taxing the surface land rent. This must be rectified.

Successful Land Value Tax Policy Implementation

Here are three examples (many can be found around the world), two urban and one rural, that this writer is most familiar with that could be easily replicated in low-income countries and elsewhere.

First is that of Harrisburg, the capitol of the state of Pennsylvania, USA. In 1982 Harrisburg, (pop. 50,000), was second on the national list of distressed cities after three decades of decline. Thereafter it gradually restructured its tax base and now taxes land value six times heavier than building value.

According to the Harrisburg Office of Business and Industrial Development, the number of vacant structures, some 4,200 in 1982, is now less than 500 and the city was voted the second "best investment" city in the Eastern U.S. two consecutive years in a national banking institution poll. Crime and fire rates dropped while businesses, private sector jobs and homes have increased. Note that the city property is only one third of the overall property tax (the remains finances the school district) and even though taxes were still imposed from the federal level, these were noted benefits.

There would be even more improvements and fewer or no vacant structures if these “dead weight loss” taxes were removed. Steven Reed, Mayor of Harrisburg from 1981 to 2005 stated: "The City of Harrisburg continues in the view that a land value taxation system, which places a much higher tax rate on land than on improvements, is an important incentive for the highest and best use of land in already developed communities, such as cities.”

The second urban example is that of Allentown, the third largest city in Pennsylvania. In 1997 Allentown (pop. 105,000) started taxing buildings less than land after a popular vote. According to analysis by the *Center for the Study of Economics Allentown’s* new construction and renovation thereafter grew by 32% in dollar value in the three years after the shift to land value taxation as compared to the prior three years.

The third example of a land value capture system that began initially to fund irrigation infrastructure is that of California’s local irrigation districts under the Wright Act. After one California rancher who owned one million acres of land won full rights to the water of the Kern River (1886), citizens organized and the Wright Act was legislated permitting local irrigation districts to build dams and canals and other infrastructure to be funded by bonds paid off by land rent.

In ten years, the Central Valley was transformed into over 7,000 independent farms. The Wright Act was amended to mandate the total exemption of improvements from the tax base.

Irrigation Districts included and taxed land that was used not only for farming but also for residence and commerce within townships. Steadily the Irrigation Districts evolved to provide reclamation, recreation, and electric power. The formerly semi-arid plains of the San Joaquin Valley became the "bread basket of America", one of the most productive areas on the planet.

In Conclusion

It is imperative that those working for climate mitigation and sustainable development have a better understanding of the classical economic concept of "economic rent" aka "commons rent" and how the socialization of rent while eliminating taxes on work and production is key to building a world that works for everyone.

Some of the many benefits of this approach detailed in this paper include financing public infrastructure, infill development of urban areas to curb sprawl for more efficient use of infrastructure and lower carbon footprint, harnessing full incentives for private sector production of affordable housing and renewable energy, sourcing sufficient public funding for other public goods, and promoting "natural land reform" for land access for intensive scale organic agriculture.

Resources and References

From the *Vancouver Action Plan* – the 1976 founding document for UN- Habitat (UNCHS):

Social justice, urban renewal and development, the provision of decent dwellings and healthy conditions for the people can only be achieved if land is used in the interests of society as a whole…. Excessive profits resulting from the increase in land value due to development and change in use are one of the principal causes of the concentration of wealth in private hands…. Taxation should not be seen only as a source of revenue for the community but also as a powerful tool to encourage development of desirable locations, to exercise a controlling effect on the land market and to redistribute to the public at large the benefits of the unearned increase in land values… The unearned increment resulting from the rise in land values resulting from change in use of land, from public investment or decision or due to the general growth of community must be subject to appropriate recapture by public bodies (the community).

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A two book series on the Alaska Permanent Fund was published in 2012 by Palgrave MacMillan contains a thorough exposition of the APF Dividend Program. The second book titled Exporting the Alaska Model – Adapting the Permanent Fund Dividend for Reform around the World contains a number of recommendations for changes that could be made to the APF that can serve as a model for new sovereign wealth funds or the improvement of current ones. See in particular section titled: *Assessing the Strengths and Shortcomings of the Alaska Model in Advance of Export*.

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