

## What's Missing from the National Debate?

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As our political leaders undertake the challenge of restructuring federal tax policy and spending activities, they should bear in mind some points that seem to have remained unaddressed from both sides of the aisle. Specifically, as policy makers and opinion shapers have begun to debate changing the way we direct resources from individual pockets to the common pot, and thereby from some citizens to others, they have paid little attention to the supply side of the analysis. These errors of omission should be corrected, because suppliers of capital and labor for the productive process will react rationally to any tax or transfer payment changes that come about.

### Taxing Questions

For example, we, as a society, can consume no more than the fruits of our collective production. Yet each of us, on average, is consuming more than did our counterparts in the past (because of longer life spans, among other reasons), while relatively fewer people are producing (because of earlier retirement, disability, or the receipt of public assistance). The daunting task of providing the consumption goods, along with medical and other services, needed by the populace therefore falls to the relatively small group that continues to produce.

These producers will have to be aided in their efforts by increasingly productive capital equipment (which might properly be owned, at least in part, by retirees who no longer directly produce). An important question becomes whether the tax environment will promote, through appropriate credits and favorable capital gains treatment, the savings to fund the needed investment in labor-enhancing assets.

Of course, tax implications have not been ignored in the debate; indeed, lower capital gains taxes are often discussed. Federal income tax, however, is not the only type of taxation that affects capital items. Local property taxation may become an increasingly important policy issue if Washington passes entitlement burdens to the states. How do opinion shapers view local taxes? In a recent editorial that pointed out flaws in *ad valorem* property taxation, a downstate newspaper correctly noted that value-based taxes can discourage property owners from maintaining or improving their holdings. Then, without any hint of irony, the writer declared that the answer to the dilemma is a heavier reliance on *income* taxes. We should wonder why the writer feels that disincentives for human productivity are less burdensome on a community than is

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**“Problems with Section 8 Rental Assistance”** (page 1) offers a discussion of our nation’s huge subsidized rental housing program, with its eligibility criteria that can provide incentives for cheating and corruption, and its implementation procedures that provide disincentives for efficient resource use. The article is followed by a detailed graphical presentation in **“An Economic Analysis of Subsidized Rental Housing”** (page 6). **“Nonlinear Effects in Land Valuation”** (page 9) explains the decline in per-unit value that accompanies growth in parcel size, and provides an example of a simple approach to measuring this impact when a small amount of land is removed from a larger tract. **“Loan Underwriting Rules of Thumb”** (page 11) outlines the use of the debt coverage ratio and the loan-to-value ratio as rules of thumb for evaluating mortgage loan quality. The authors explain why standards typically imposed for these ratios may be more restrictive than is necessary to provide reasonable assurance against potential default. **“What's Missing from the National Debate”** (page 16) discusses several supply-side issues that should be considered as Washington grapples with tax and budget decisions. Among these issues are the nature of savings and investment, incentives for productivity, and policies affecting the real estate environment.

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## Thoughts for the Day

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deferred property maintenance. We might also question whether maintenance and improvement of the income-producing real estate that supports production would be adversely affected by localities' greater reliance on income-based taxes.

### Are We Burying Enough Acorns?

Our inattention to important capital supply questions does not end with tax matters. We openly worry about whether our private and government retirement plans are adequately "funded" without considering the fundamental nature of the savings process. First, each individual can (on average) consume, over his or her lifetime, only the value of what he or she produces during the working years, or in a home workshop and backyard garden after retiring. As we live longer, the level of savings sufficient to fund a privately or institutionally administered retirement plan ratchets upward. Each of us must either keep producing for a longer time (by retiring later or engaging in more self-help activity) or else consume less, and save more, during the working years.

But second, and more importantly, dollars channeled into such savings vehicles as securities and real estate must build a proper foundation for future productivity; otherwise, how will we be fed and clothed as retirees? While past technological success allows a small number of workers to produce today's necessities of life even as we devote increasing resources to leisure and entertainment, at some future point we could find ourselves approaching George Bush's troubling caricature of an economy based on delivering pizzas to each other. If we do not foster a legal and political climate (including protections for property rights and against frivolous lawsuits, in addition to supportive tax and regulatory policies) that encourages long-term investment in technology, and in the real estate and other infrastructure components to support technological gains, then the remaining producers will not be able to provide for consumers' growing needs.

People save by willingly consuming less than they produce currently, handing to others money that represents claims on value produced but not immediately consumed. If those dollars, and the pro-

ductivity that they represent, are frittered away because productive acts are insufficiently rewarded, then we may all be drawing our belts much tighter in the not-so-distant future. In other words, as we hold back on consuming in order to save, someone had better use our savings in a way that promotes future production.

### Raking It In

Tax issues also have been raised in discussions of the returns to human labor. It has been noted, for example, that people with low-paying jobs in Postwar days could buy homes and support families because low taxes left most earnings in household hands. We are told, accordingly, that marginal income tax (and other tax) rates must be lowered so that

families can afford to provide for themselves. While that reasoning is sound as far as it goes, no concern seems to have been raised regarding the pain that working families feel through the rising prices of unskilled services.

For example, one Illinois couple was recently quoted a price of \$30 for raking their leaves, a two-hour job. The enterprising groundsman was charging what the market would bear in light of the low supply of people willing to perform such manual tasks. One concern of these workers may be their own tax situations, although few among us would believe that all informal, cash-only enterprises fully comply with the income tax laws. The more pressing question for some unskilled workers boils down not to what could be earned after taxes in the next best job, but rather to what lifestyles could be sustained if they did not work at all. The typical American worker is said to be toiling longer hours and to be facing increasing job-related stress. It is unfortunate that this beleaguered individual, at the end of a long and stressful day of producing, can not afford to pay someone to rake the leaves or mow the lawn.

### Seeking Greener Pastures?

At the same time, we dare not lose sight of the importance of marginal income tax rates that are sufficiently low to keep producers producing. If more of the revenues for various levels of government were to be derived from income-based taxes, then those willing and able to produce would see increasing amounts of their output taken for reassignment to others. If productivity is too heavily taxed, then we can expect to suffer a "brain drain," in which productive individuals remove as much of their activity as possible from the tax rolls.

One means of such removal is the underground economy, with its activities running the gamut from squeaky-clean to clearly illegal. For example, a skilled

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worker who grosses \$23 per hour but clears only \$14 after all income-based taxes, and who must pay \$15 per hour to have leaves raked, is better off by simply working fewer hours and doing her own yard chores. While such do-it-yourself activities are entirely legitimate under our current tax law, they divert workers from applying their special skills, and thereby reduce the total of goods and services available in the marketplace. Perhaps a reason why unskilled workers face difficulty in securing jobs is that many heavily-taxed individuals find it cheaper to work fewer taxable hours, and simply to do unskilled tasks for themselves.

Other forms of underground activity, such as unreported bartering or outright criminal acts, clearly are illegitimate, but can prove attractive to those who view the taxed economy as unfair. Of course, an extreme alternative is for the best producers simply to leave the system. If the most productive Americans can not keep a sufficient portion of the fruits of their labor, then perhaps the next generation of physicians and engineers in India and the Far East will be individuals who were born in the United States. ■