ECONOMICS & FINANCE

LAND VALUE TAX: A VIABLE TAX ALTERNATIVE?

HENRY LAW, LAND VALUE TAXATION CAMPAIGN

Land value tax (LVT) has been high on the political agenda for most of the past two centuries; in the three decades up to World War I it was backed by a widespread popular movement. Thus, in the broader perspective, its eclipse since about 1950 is exceptional. The flurry of fresh interest in recent years is due, amongst other things, to the realisation that tax systems have hit the limit to what they can raise, whilst expectations of government continue growing and attempts to cut large welfare bills consistently fail.

LVT in its classic form is a tax on the annual rental value of all land, ignoring buildings and other developments, the valuation being on the assumption that the land is at its optimum use. It would not be additional to existing taxes but a partial or complete replacement for them. Proponents argue that it is a precondition for the solution of a wide range of apparently intractable economic ills. Opponents usually come up with objections which are criticisms of what is not actually being proposed.

Because LVT is grounded in the fundamental ethical and philosophical issues associated with property rights, a vastly bigger subject than can be accommodated here, this article will confine itself to the economic rationale and mechanics of LVT and trace its likely effects.

I. WHAT IS LAND VALUE?

When talking about land value, what do we mean? Land costs nothing to produce so why does it have a value at all? Amongst the first to analyse this was David Ricardo, who formulated the Law of Rent linked to his name. Ricardo used wheat farming as a model, but we might find it easier to understand the concept by taking the example of a busker on the London Underground. Given reasonable competence, buskers' earnings will depend on where they play. These days, busking is regulated, but what if it were not? The first busker to arrive would go to the most lucrative spot at the busiest station – Victoria – and perhaps collect £30 in an hour. The next busker would have to settle for second-best, say Tottenham Court Road, and take £25. And so on – at Euston and South Kensington a busker could pick up £20, at Stratford £15, at Wembley £10, at Warwick Avenue £5, and at Kew Gardens £10 but only on Saturdays and Sundays in good weather. At stations like Gants Hill in the outer suburbs they might collect just a pound or two. If this sounds like the Monopoly game, it is meant to. Originally called "The Landlords' Game", Monopoly was invented to demonstrate the same point.

This model acknowledges that there is a minimum level of earnings, below which buskers will not consider it worth their time and effort to busk. Whilst this is to some extent subjective, the model is determined by what else they could be doing instead of busking. At a guess, it is probably around £10 an hour these days, at somewhere like "Wembley". That, according to Ricardo's Law, is the "marginal site". Buskers would not bother with anywhere below the margin – under the dotted line in the table. Margins are important because they are where key economics decisions are made – Warwick Avenue, a quiet station on the Bakerloo, is not worth bothering with. The plum spot at Victoria gives the occupant £20 an hour more than could be picked up at Wembley. This is known in classical economics as "economic rent of land". It is a bonus due to the advantages of the site itself, arising because there is a concentration of people at the best locations, where routes converge.

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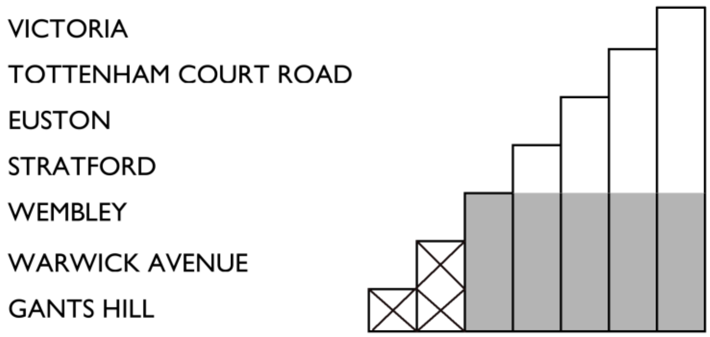

The areas left white in the diagram represent rents, the grey area represents the wages earned by the buskers, and the sites marked with an X are not viable.

STATION	**A TAKINGS (£)**	**B RENT (£) A–£10**
VICTORIA	30	20
TOTTENHAM COURT ROAD	25	15
EUSTON	20	10
STRATFORD	15	5
WEMBLEY	10	0
WARWICK AVENUE	(5)	–
GANTS HILL	(2)	–
TOTAL	100	50

If an additional route was built which brought more traffic to Victoria, the advantage would be even greater. Conversely, if the new line drew traffic away from Victoria, the takings there would drop and somewhere else would become the top spot.

Such is the advantage of the best locations that a means must be found for allocating them. People might come to some informal agreement, or have a fight, or there might be a protection racket running, in which case the mafiosi could get away with relieving the musicians of the best part of the rental value.

What if the authorities, London Underground, had noticed that here was a useful additional source of revenue and set up a system of revenue-sharing, on the basis of “ability to pay”, by levying an “income tax” on the buskers? If the buskers had to pay, say 20% of their takings, things would then be as reflected in the next table.

STATION	**A TAKINGS (£)**	**B TAX (£) A x 20%**	**C NET (£) A–B**	**D RENT (£) C–£12.5**
VICTORIA	30	6	24	11.5
TOTTENHAM COURT ROAD	25	5	20	7.5
EUSTON	20	4	16	3.5
STRATFORD	15	3	12	2.5
WEMBLEY	10	2	8	–
WARWICK AVENUE	5	–	–	–
GANTS HILL	2	–	–	–
TOTAL	90	18	72	25

Busking at Wembley is no longer viable because the busker ends up with only £8. The margin has now been raised to locations where the takings are at least £12.5 before "tax". Sites which would have been viable in the absence of the tax are now below the margin of viability.

The tax has destroyed work opportunities. There is an overall loss in production. Tax has cut into both aggregate takings and aggregate rental values. This is called a "deadweight loss". The "income tax" does not address problems of allocation; possible protection rackets remain because rent is still retained by the occupants of the viable sites. The system would be troublesome to run: the authorities would have to check how much each busker collected. People could cheat. It would also be unfair, since it would punish the better players.

This is a model for most contemporary tax systems where the tax is a proportion of income or profit. Marginal sites are knocked out of use because the potential for productive activity is below the threshold of viability. The same picture is repeated at a national scale. This is why regional imbalance in national economies is so intractable. The natural disadvantages of Scotland and Cornwall are amplified by the tax system. The same applies in most countries. In this way the economies suffer from a deadweight loss due to the taxation of wages and profits. The taxation of goods and services has the same effect. This is one of the reasons why existing tax systems are stretched to the limit.

To summarise: equal amounts of labour and capital do not result in the production of equal amounts of added value. Differentials due to location give rise to rental values. More can be earned for the same effort at the most advantageous locations, and so people will pay a premium to use them, known as economic rent of land.

Land *rental value* is not the same thing as land *price*. The two are related, but people generally equate land value with its *price* – what someone is willing to pay for it – without realising that land price is a derivative value. When one buys land, one is purchasing the stream of rental income from that land, just as one would buy an annuity. The revenue stream goes with the land title. That price depends on factors like the interest rate, future

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expectations of income and other speculative considerations such as the possibility of building houses on agricultural land, or perhaps the chance of new infrastructure – a motorway or railway – in the vicinity. The purchase of a land title is always a gamble. It is not a one-way bet. If, for instance, the taxpayer stops looking after the infrastructure or the economy changes in significant ways, it can be a losing bet.

II. MORE DEADWEIGHT LOSSES

Before moving on to LVT, we need to take note of other deadweight losses due to the so-called "tax wedge" – the difference between the real purchasing power of net wages and the gross labour cost to employers. To purchase £100 of goods one needs about £120 in one's pocket to cover VAT and other taxes on goods and services. To earn that amount in net pay, the employer incurs a gross labour cost of around £190 – the difference consisting of income tax and National Insurance charges nominally paid by the employee, and the employer's National Insurance contribution. It is a barrier against employment. Some people, school-leavers, immigrants and people with low skills, are unable to produce sufficiently to leave them with an acceptable wage. They are caught in the benefits trap. Unskilled work that they might have done is either not done at all, or employers replace labour by expensive capital. This is why services like cleaning and care work are pared to the bone, whilst supermarkets have introduced self-scanning. There is a real economic loss, with taxpayers being burdened with the cost of welfare.

III. WHAT IS LVT?

In the case of our buskers, LVT would be the equivalent of making a charge for each site according to a tariff, based on the rental value. The buskers would buy a permit for a busking session. The value could soon be established by testing the market. It would be easier and fairer than collecting a share of the takings. That would be the end of the matter, as the amount the buskers took would be of no concern to anyone. In practice, the easiest thing to do would be to charge the full rental value, leaving everyone with the same amount as they could have made at the marginal site. Rent is an equaliser. For the sake of illustration, however, if the charge were levied at a rate of 40% of the rental value, and since nothing could now be charged for the use of "Wembley", the end result would look like this.

Too much should not be read into these figures but the aggregate take is the same as it would have been in the absence of the tax, because the marginal sites remain viable. The amount of "tax" collected in this example is about the same as under the income tax system discussed earlier, whilst aggregate pre-tax rental values have gone up by roughly the amount of "income tax" that no longer has to be paid. Busking remains viable on any pitch where £10 can be earned, eg "Wembley". The margin stays where it would be in the absence of any tax. Sites close to the margin are not knocked out by the tax.

STATION	A TAKINGS (£)	B RENT (£) A–£10	C TAX (£) A x 40%	D NET (£) A–C	E NET RENT B x 60%
VICTORIA	30	20	8	22	12
TOTTENHAM COURT ROAD	25	15	6	19	9
EUSTON	20	10	4	16	6
STRATFORD	15	5	2	13	3
WEMBLEY	10	0	0	10	0
WARWICK AVENUE	5	–	–	–	–
GANTS HILL	2	–	–	–	–
TOTAL	100	50	20	80	30

Disadvantages of location are not amplified as they are by taxes on incomes or profits, so the number of sites of opportunity is optimised. Aggregate rental values are unaffected, since what is happening is a *sharing* of rental values between London Underground and the buskers. The tax does not cut into its own base. Thus a tax on rent is an exception to the Laffer rule; the yield is proportional to the tax all the way up to 100% ie when the full rental value is charged. This is of course exactly what, as landlord, London Underground does when it leases kiosks on its premises to newsagents and retailers. There is no shortage of tenants.

Before leaving our musicians, there is one further point to be made: LVT is not really a tax at all. Land Value Taxation is a misnomer. It is functionally equivalent to a national land rent charge, where the taxpayers pay for what they get, and get what they pay for.

IV.LVT IN PRACTICE

Administratively, LVT works in a similar way to the UK's national business rate, the only difference being that all land is registered and assessed, and buildings and improvements on the site are ignored. This simplifies the system. A rate of tax is set and owners of the land are billed, just as business occupiers are billed today.

V. VALUATION

Objectors argue that valuation of sites is difficult. Yet professionals do it all the time. When a valuer says that house A is worth a certain amount, whereas an identical house B in a different location is worth more, the valuer is assessing the relative site values. When a property comes on the market for major redevelopment, it will be valued as a site, minus the costs of demolition and clearance. Pilot-scale surveys have confirmed that the establishment of site rental values for LVT purposes would present no special difficulties. These days, property websites used both by estate agents and the public mean that anyone who wants to know can work out property site values.

Under a system of land value taxation, valuers assume that the site is developed to its maximum extent consistent with the planning regulations. In most circumstances it would

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be existing use value, but if the property was allowed to become derelict or demolished, the owner would remain liable for the land value tax, in contrast to what happens with the present property taxes. Because third-party planning applications can be made, for example, by local authorities, owners of land that was ripe for development, such as urban fringe, would not be able to play the market by withholding it.

For an LVT system to function openly and effectively, the register and valuations must be available to the public, and revaluations must be frequent – certainly at not more than five-yearly intervals. With modern Geographical Information Systems, annual revisions become feasible.

VI. NATIONAL OR LOCAL?

Technically, LVT is suitable for all tiers of government because a system of precepting can be used. In practice however, because of the variation in aggregate land values between different local authorities, LVT should be a uniform national tax; at a given percentage rate of tax, many times more revenue can be raised in Kensington than in Kendal. This is, however, true of any tax – the same applies to a local income tax or a local sales tax. It is why local taxation in any shape or form tends to be a political minefield.

VII. THE BENEFITS

The aim of LVT is to replace, initially, existing property taxes, and to allow the phasing-out of other damaging taxes. Because, as shown earlier, existing taxes cut into land values, those land values rise as present taxes are cut. This is why it is impossible to answer a question that is often posed – "how much can LVT raise?" It depends on what other taxes are removed. Broadly speaking, aggregate land value increases on a £1 for £1 basis as other taxes are cut. Assuming that LVT is sufficiently high, the benefits include:

- Reduction of deadweight losses and associated poverty and unemployment.
- Discouragement of land speculation – LVT must be paid whether land is in use or not. Buying property or land, and leaving it empty or undeveloped, becomes unprofitable, as does the under-use of valuable sites.
- Minimal administration costs.
- No avoidance and evasion. Land cannot be hidden or removed to a tax haven.
- Credit-fuelled boom-slump cycles curbed. LVT knocks the speculative element out of land pricing and by acting as a negative feedback loop, prevents the development of price bubbles.
- Land value tax cannot be passed on. Rents settle at the maximum that can be obtained. Landlords cannot raise them on account of a land value tax – on the contrary – the competition between them is sharper and they must accept the

best price they can to keep their property occupied and maintain their revenue from which to pay the tax.

VIII. WHY HASN'T LVT BEEN TRIED?

Actually it has, and remains in operation, though usually at a low level and as a local tax. Examples are Singapore, Taiwan, Australia, parts of the USA and Scandinavia. LVT is an important factor in the success of the economies of the first two. To the extent that they are set up on sound principles, ie based on annual rental values with frequent revaluations, they run smoothly and efficiently. Many countries already have a property tax of some kind and in these cases the existing system can be adapted, since land value taxation is a simplification of existing taxes levied on land plus buildings.

IX. WHAT IS THE DIFFICULTY?

The biggest difficulty in getting LVT accepted and implemented is that there are vested interests in keeping things the way they are. Home owners enjoy the rental stream from their own properties as an imputed income, and they cherish the prospect of the windfall gains which they can enjoy. More significantly, the entire system of banking and finance is constructed on the appropriation of land rental value by private individuals and companies. Some people do nicely, and behind them is an army of others who aspire to do the same thing. Many seem to be attached to the psychological comfort of land ownership and find the notion of a tax threatening, whilst ignoring the prospect of tax-free earnings and tax-free goods in the shops which would be possible if LVT substantially replaced existing taxes. As pointed out at the beginning of this piece, there are ethical and philosophical issues associated with property rights. Until these are recognised and attitudes change, LVT is not going to come easily.

HENRY LAW has pursued a diverse career. After graduating in Chemistry at Lincoln College, Oxford in 1963, he worked for a time as a science teacher, before following up a long-standing interest in architecture, town planning and landscape design, obtaining a qualification in the latter subject at Newcastle University. He subsequently worked within that field until 1991, as a local authority planning officer and freelance journalist. His interest in land taxation arose through an awareness of the link between the tax system and seemingly intractable problems of land use policy. He currently lives in Sweden, having moved there several years ago.