

# TAXING LAND VALUE IS JUST ANOTHER QUESTIONABLE TAX

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*There has recently been much public debate about the introduction of a land value tax. To its supporters such a tax promises to achieve several goals simultaneously. On closer inspection, however, the arguments in favour of land value taxation are not convincing. On the contrary, the economic foundations on which proponents of this tax rely are dubious, and there are significant legal, moral and practical problems with land value taxation.*

## **Curious coalitions for a ‘panacea tax’**

One of the most curious coalitions in British politics has formed around the question of land taxation. The new Liberal Democrat environment spokesperson Chris Huhne MP, former Conservative minister David Curry MP and former Labour cabinet minister Tony Benn may not share many political convictions, but they have all spoken out in favour of the introduction of a land value tax (LVT).

With land values having reached astronomical heights, it is rather unsurprising that politicians realise how much money could be collected if land value was taxed. To many of the supporters of land value taxation, however, a potential LVT is not just another government revenue-raising measure, but something much more profound. They make a moral case for it by claiming it would only tax ‘excessive, unjustified rents’ without distorting the market. They claim it would solve the housing crisis by bringing idle and under-utilised land back into the market. At the same time they believe LVT would also counter ‘urban sprawl’, keep land prices and interest rates low and stop land speculation. Some of the most ardent supporters like Dave Wetzel, vice-chair of Transport for London and chair of the Labour Land Campaign, even go further than this: he claims that LVT would also stop tax avoidance, create sustainable communities and lower other forms of taxation such as income tax. In other words: LVT, properly enacted, could cure all sorts of problems that modern society faces, according to its supporters.

All the things mentioned give the impression that LVT could be an extremely attractive form of taxation with lots of positive side effects – the

economic equivalent of a panacea. There is only one problem with this approach: It is deeply flawed both from an economic, a moral and a pragmatic perspective.

## **The long history of land value taxation**

LVT is certainly not a new idea. It was first propagated by the French physiocrats of the eighteenth century. Later classical economists like David Ricardo developed a theoretical foundation for LVT. The most outspoken theorist was the American publicist Henry George in the late nineteenth century. He went so far as to suggest that a single LVT could replace all other forms of taxation.

Modern economics has certainly started with the classics, but it has not stopped there. Today we see that most of the arguments in favour of LVT rest on a few axioms that are either highly questionable or outright wrong. First, it is assumed that land ownership does not fulfil any economic function and that, therefore, all income received from owning land is basically unjustified, even unjustifiable. In order to reach this conclusion the supporters of LVT since David Ricardo have divided land rents into rents that derive from the land itself and rents that derive from the improvements done to this land. For example, if one cultivated a piece of land or built a house on it, then such investment would – even in the eyes of LVT supporters – justify an income. But the income that simply flows from the ‘indestructible powers of the soil’ (Ricardo) would not.

In practice, however, one could hardly ever separate the incomes from land and from

improvements to the land. It would take a government agency and some highly questionable assumptions to determine which part of the value of the land was 'justified' and which was 'unearned' and thus taxable. But worse than that, modern economic analysis has moved beyond the old Ricardian land value theory and concludes that each factor of production will receive its marginal product. This means that land does not receive the residual value of all economic activity, but capital and labour equally receive value according to what they have contributed.

There is a more fundamental flaw in the reasoning of the supporters of LVT. They assume, implicitly or even explicitly, that landowners do not perform an economic function. Their perception of landowners is that they do not contribute the least to the economy, yet at the same time they reap large profits from owning their land. From this perception it is not far to the claim that their allegedly undeserved profits from land should be taxed away.

### **The landowner as entrepreneur**

Closer inspection, however, reveals that landowners perform a number of valuable economic tasks. Like the owners of any other factor of production, landowners have to make frequent decisions on what use to make of their property. They decide in which way to utilise their land, which could mean to keep land idle. For one, there is much more land than there is labour to keep all land in use all the time. Secondly, it can be necessary at times to keep land from the market and wait for a better opportunity to bring it back into use, for example when there is a chance to develop a larger area. These decisions have to be made, and they have to be made by someone who bears the economic consequences. This is the task of the landowner who accepts the residual risk and takes the opportunity costs of withholding land from its most valuable unrealised economic potential. In many ways, the role of the landowners resembles that of entrepreneur-investors in other markets. Like any other investor they have to allocate scarce resources over time and ultimately direct them to their most productive uses. To take this role from them by means of taxing the value of their property means creating a distortion in the market as landowners would be unable to make independent decisions about their property. It resembles a kind of central planning in the land market.

People owning land should be treated like people owning other forms of capital. Owning a factory, money in a bank account or a plot of land should thus not be taxed on their respective values, but on the actual income – not a hypothetical income – generated from them. The proper tax for

this is the income tax. An additional land value tax would be both unnecessary and undesirable. Besides, it would not fit into our general approach to taxation. In our current tax system people are usually not taxed for the resources they own but for the income they make from these resources. For example, you would not be punished if you decided to keep your money in a money sock or a piggy bank instead of directing it to a high-interest investment. You would only be taxed once your capital yields an income. Thus the capital owner is free to decide how to use his resources, even if that means running the risk of not making the most of them. In a market economy with individual autonomy, however, this is something that has to be accepted. It is the general principle of a market economy with private property rights that property owners are free to make their own decisions.

As we have seen, in a market in which landowners make decisions about land uses, an LVT would have severely negative economic side effects. Yet in Britain, land-use decisions are not only made by landowners, but also by planners. In effect this means that landowners would often not even be able to make the most of their land, but they are restricted to what planners have allowed them to do. But when it then comes to imposing an LVT on these landowners, on what value should this tax be based? On the current use value, on the use allowed by the plan, or on some fictional use regardless of what is currently permitted? Once again, an LVT would turn out to be a source of extreme legal uncertainty – and it would be difficult to implement, practically.

### **The moral problem of land value taxation**

In addition to all these economic difficulties, there is a further moral complication to LVT. As the supporters of LVT claim, the tax should be levied on the intrinsic value of a site. But it turns out that such values often depend on the surroundings of the plot and not only on the plot itself. There is no purely intrinsic value, especially when it comes to land in the cities. In other words, changes made by your neighbours will affect the value of your property. If your neighbour builds a polluting factory, your land value and thus your LVT will fall. If your neighbour, however, opens a theme park or if a new tube line stops in front of your door, your land value will increase and with it the tax you would have to pay on it. So in other words, the tax one has to pay does not actually depend solely on one's own property positions, let alone one's financial situation, but on the consequences of other people's actions. Surely, such a system of taxation cannot be regarded as fair or just.

Nor would it be fair or just to treat different circumstances equally for tax purposes. Two landowners may have equally sized plots of land in similar locations, but one of them may have a big, luxurious house whereas the other one only lives in a small cottage. One may have a high income, whereas the other one lives on a small pension. Yet when it comes to paying their LVT both would be assessed on the value of the land alone, regardless of real estate values or income. Most people would not think that such a tax system fulfilled the basic criteria of equity. It is actually the same argument against LVT that is also often used against council tax, i.e. that it is unfair to treat different circumstances equally and that it is highly regressive.

### Conclusion

To sum it up, LVT does not hold the promises its supporters frequently make. In practice, it would simply be another tax, which would create distortions in the property market, lack legal certainty and violate some basic moral principles of taxation. It may be understandable that politicians of otherwise different convictions may all realise the budget-increasing potential of introducing an LVT. But the potential tax revenue should not make us blind to the serious shortcomings of taxing land value.

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