compass

DIRECTION FOR THE DEMOCRATIC LEFT

The case for land value taxation

By Iain McLean

Compass Thinkpiece Number 2

Context

The idea that property taxes should be based on the value of land is ancient. It goes back to Adam Smith. In the United Kingdom, it was intended to be the centre piece of Lloyd George's 'People's Budget' of 1909, but was defeated by the vested interests of the House of Lords and property owners in the House of Commons. Lloyd George was the most radical Chancellor until Gordon Brown, who admires his Liberal predecessor. Brown (or his successor) has a chance to carry through what Lloyd George tried and failed to. Land value taxation (LVT) is an idea whose time has come. It is supported all the way across the political spectrum from Sir Samuel Brittan of the *Financial Times* to Dave Wetzel of Transport for London.

The basic idea is that the supply of land is fixed. They aren't making it any more. Therefore it is inherently scarce. Its price reflects three things: its scarcity value; the value of improvements made by the landowner; and the value of improvements made by other people, especially the public sector. In modern conditions the first and third of these almost entirely swamp the second. Therefore it is right and fair that value created not by the landowner but (mostly) by national and local government should be taxed. The most eloquent statement of the case comes from Winston Churchill, when he was a Cabinet colleague of Lloyd George in 1909:

> Roads are made, streets are made, railway services are improved, electric light turns night into day, electric trams glide swiftly to and fro, water is brought from reservoirs a hundred miles off in the mountains – and all the while the landlord sits still… To not one of these improvements does the land monopolist as a land monopolist contribute, and yet by every one of them the value of his land is sensibly enhanced.

That is even truer than it was in 1909, because since 1947 the UK has had a command-and-control system of land-use planning. The market value of a tract of land can go up a hundredfold when its designation changes from agricultural to commercial.

In 1947 the Attlee Labour government tried to capture some of the uplift in land values by a development gains tax. It failed. So have all intervening attempts. Along with the December 2005 Pre-Budget Report the Chancellor put the latest proposal, now called 'planning gain supplement', out for consultation[1]. Planning gain supplement is better than nothing but it is much worse than land value taxation.

But things are stirring in other parties as well. The Liberal Democrats have a Tax Commission sitting at the time of writing, which may ease them out of their commitment to a local income tax, and back towards their historic support for 'site value rating', which is just LVT for business premises levied by the local authority. The Green Party adopted LVT for the 2005 General Election. The Conservatives know that they are against Council Tax, but don't currently know what they favour.

Everybody agrees that Council Tax is a bad tax: it is regressive, and it increases faster than the cost of living, unless the Government bails out Council Tax payers with more central subsidy. But the more the centre subsidises local authorities, the worse is the 'balance of funding', on which the Office of the Deputy Prime Minister held an inconclusive review in 2003-4. Funding is unbalanced because local councils provide services that the centre mostly pays for, which is bad for both tiers of government. Councils spend money that they are not responsible for raising. The Treasury yearns to control how the money is spent, which tends to destroy local autonomy. And in what the minister, David Miliband, himself called 'a vaulting, 180-degree full on U-turn,' the Government has abandoned the revaluation of properties for Council Tax which was due in 2005. Truly, local taxation is in an unholy mess.

Analysis

Taxation of land values is taxation of economic rent. That is why it carries off the unique double of being both the fairest and the most efficient tax. Economic rent is the amount that a factor of production earns beyond that which it would earn in its next best use. Consider a field on the edge of a city. As agricultural land it is worth maybe £10,000 a hectare. With planning permission for housing or a hypermarket it could be worth over £1 million a hectare. The difference is the economic rent it commands if it is used for houses or a hypermarket.

Taxation of economic rent is fair for the reason Winston Churchill gave. The landowner, as landowner, has done little or nothing to procure the gain – it was conferred by the state acting on behalf of the electorate. Therefore the electorate ought to see some of the returns. It is efficient because, so long as the final value of the land after tax is greater than £10,000 a hectare, it is still worth entrepeneurs' time and effort to develop it. All taxes distort desired economic activity. But taxes on economic rent distort it less than any other sort.

---

1 HM Treasury, *Planning-gain Supplement: a consultation*. London: HMT, December 2005. Web version at http://www.hm-treasury.gov.uk/media/F59/D3/pbr05_planninggain_449.pdf. The consultation is open until 27 February 2006.

One of the many things that LVT could do is pay for infrastructure improvements. That is why officials of Transport for London are so keen on it. It has been calculated that the Jubilee Line extension to Stratford has raised property values around the stations by £10 billion. If only a small part of this windfall had been taxed, it would have paid for the extension very easily. On the same argument, an LVT could easily pay for the Crossrail project across north London, and many other much-needed infrastructure schemes.

It also offers a more robust base for local taxation than the present mix of Council Tax and business rates. Council Tax is regressive because it imposes a lower burden on the rich than on the poor – and also a lower burden on rich *places* than poor places. Business rates were nationalised in the backwash of the Poll Tax fiasco, so that local authorities have no real incentive to improve their tax base (the Government has tacked an artificial and ultimately unworkable incentive on to the creaking system).

Finally, a land value tax would do all (and much more) that the proposed Planning Gain Supplement (PGS) would do, without its crippling disadvantage. With all previous PGS's, developers have simply waited for the Conservatives to return to government and abolish the tax, so they have withheld land from development, thus defeating the purpose of the tax.

Prescription

The government should replace Council Tax by an *ad valorem* (i.e., proportionate) tax on the values of houses. It should replace Uniform Business Rate by a tax on the site value of land, to be levied by local authorities. And it should completely overhaul the baroque and obscure system of equalisation grant, by which resources are redistributed from rich council areas to poor ones.

According to the Halifax, the value of the housing stock in the UK 'was £3.3 trillion at the end of 2004, more than 50% higher than three years ago and three times the value of the housing stock in 1994'. According to the Treasury, the amount raised by Council Tax in 2005-06 will be £21 billion. And according to the 2001 Census, there are 22.5 million houses in England and Wales, which extrapolates to about 25.57 million in the UK .[2] Therefore, the average *ad valorem* tax to be paid on each house in order to raise the same sum as Council Tax is only about £825, which is a rate of about 0.64 pence in the £. Most households would pay less under an *ad valorem* tax than under Council Tax, because unlike now those in expensive houses would pay their fair share. Unlike Council Tax, this would help to damp housing booms; and, because much of the value of houses is the value of the land they stand on, it would approximate to a land value tax.

---

[2] Sources: http://www.hbosplc.com/economy/includes/05-02-05UKHousingStock.doc; HM Treasury, *Pre-Budget Report 2005*, Cm 6701, December, Table B12; http://www.statistics.gov.uk/census2001/profiles/commentaries/housing.asp.

‘But what about the Devon pensioners?’ I hear. There are actually very few poor people living in rich houses – about 2% of households. They can easily be accommodated by lifting the asset threshold for Council Tax benefit eligibility and by allowing them to roll up tax liabilities. They should not distort the discussion of the best property tax for the other 98%.

Business rates should be returned to local authority control, with the rate based on site value. To prevent local authorities from loading the tax burden too much on business, the annual percentage increase in business rates, in each authority, must be no higher than the percentage increase in the house tax.

These taxes would be vastly better than the Government’s proposed PGS. They would capture uplifts in value in all properties, not just those covered by a recent planning permission. They would enable the chancellor to get rid of some unwieldy and inappropriate taxes, such as Stamp Duty, and Inheritance Tax on the deceased’s main residence. Chancellor Brown (or his successor) could finally catch up with the radicalism of Chancellor Lloyd George.

Iain McLean is Professor of Politics at Oxford University.

He has contributed to the recent IPPR publication “Time for Land Value Tax?”