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Land-value tax
Why Henry George had a point

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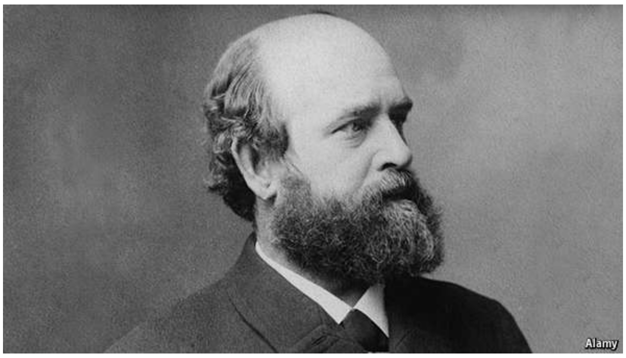
IN THIS week's print edition, we take look at land and its importance as a factor of production



(http://www.economist.com/news/leaders/21647614-poor-land-use-worlds-greatest-cities-carries-huge-cost-space-and-city) . In particular, we argue that poor land use in the world's biggest cities carries a huge cost. Many economists have argued for a land-value tax, which could be used to make the property market more efficient.

LAND prices mainly reflect location: farmers may till the soil, or drain it, but most increases in land's value comes from the activity of other people. Nobody builds skyscrapers or shopping malls in the wilderness. Landowners, in other words, enjoy unearned income from the benefits bestowed by good transport links, and proximity to customers, suppliers and other businesses. Once they have bought their land, they keep this money.

But why not tax it? That simple but revolutionary idea has deep roots. David Ricardo termed unearned income from land as a pernicious anomaly: "that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil".

His best-known follower was Henry George, perhaps the only tax theorist in history whose beliefs have become the object of almost cult-like devotion. One of his fans invented the game now known as Monopoly, to exemplify the evils of untaxed rent. In a book called "Progress and Poverty", published in 1879, George argued that land-value levies should replace all other taxation, leaving labour and capital to flourish freely, and thus ending unemployment, poverty, inflation and inequality.

His modern adherents rarely go that far, but land-value taxation (they prefer to call it a location fee) does have many theoretical virtues. Most taxes—on profits, value-added or income, say—dampen and distort economic activity by changing incentives on the margins. Property taxes on the value of buildings penalise improvement and are hard to assess. Britain's residential-property tax, for example, is based on valuations from more than 20 years ago. A "mansion tax" on homes worth more than £2m ($3m), backed by Britain's Labour and the Liberal Democrat parties, faces a big hurdle in assessing which dwellings it will affect.

Most taxes do not just depress economic activity; they also displace it—for example to offshore financial centres. The faster that tax collectors crack down on loopholes, the more clever accountants find new ones.

Land-value taxes, on the other hand, lack these perverse effects. They cannot reduce the supply of land, or distort decisionmaking. Instead they may even stimulate economic activity, by penalising those who hoard land and keep it idle (a big plus in desolate post-industrial cities where much land is vacant). The tax drives the land price down by the capitalised value of the future levies—theoretically even to zero—until someone finds a use for the land. Collection is cheap. Unlike profit, you cannot massage land away or move it to Luxembourg. If you do not pay, it can be seized and sold. Though nobody likes extra taxes, new land-value levies could be matched by cuts in other taxes, especially those paid by poor people.

Rich people tend to own a lot of land, poor people very little. For that reason it wins favour with economists who worry about inequality, such as the Nobel-prize winner Joseph Stiglitz. He argued in a recent paper that land and housing, rather than the distribution of income and productive capital, are the key to a fairer economy. When public investment improves the value of a site—for example by building a new road nearby—the benefit comes back to the community in the form of higher tax receipts, rather than ending up as a windfall in the pockets of the owners. Taxing the unearned income that landowners enjoy should curb the boom and bust cycle in land prices. Environmentalists like it because it limits urban sprawl: better to build upwards than outwards. In the New York metropolitan area, the price of land has risen five-fold between 1986 and 2014, according to research by the Lincoln Institute, a think-tank.

Other economists like it too. Adam Smith said "nothing could be more reasonable"; Milton Friedman termed it "the least bad tax". Winston Churchill said scornfully that a landlord "contributes nothing to the process from which his own enrichment is derived". The Organisation for Economic Cooperation and Development, a Paris-based thinktank for industrialised countries, supports the idea. So too did a recent working paper by the International Monetary Fund and the Mirrlees Review of British taxation by the Institute of

Fiscal Studies. The mayor of New York City, Bill de Blasio, hopes that taxing vacant lots by value will help deal with urban blight in the Bronx and elsewhere.

Ballots and beggars

The idea has wide-ranging support among modern economists, and more than 30 countries have some form of land-value taxation, usually in harness with other property taxes, on buildings. But like many ideas that work beautifully in theory, the practical and political difficulties are daunting. The biggest problem is that to raise money and change behaviour, the rate of land-value taxation will need to be quite high. This arouses furious opposition from landowners, in most countries a potent lobby, see it as highly unfair. They have got used to enjoying their rents and object to their sudden socialisation. In effect, it is a breach of property rights: the owners have paid for their land out of taxed income, so why should its benefits now be confiscated by what is in effect an arbitrary tax on some assets?

Another problem (as with any new tax) is balancing winners and losers. Some categories of land (private golf courses and urban car dealerships, for example) are likely to be hit especially hard. So too are urban homeowners with gardens: the tax will encourage them to build on them, which is good for the housing stock but bad for the environment. Some pensioners may own a valuable and much-loved house but not have the means to pay the levy. The temptation to tweak the tax to soften these problems is great. Even fiscally purist Estonia, which adopted a land tax after it regained independence in 1991, now has multiple bands, including an exemption for homeowners.

A third problem is that valuation of the high-priced urban land (rarely sold as vacant plots) may be tricky—and controversial. Wealthy commercial landlords could tie the assessment process up in costly legal knots.

Some of these objections could be overcome. A land tax need not be implemented overnight. It could be phased in, which would mean market signals started working before the levies were actually paid. Hard-up owners of valuable land could be allowed to commute payment until they die. Valuation of urban land, with a bit of maths, is not insuperable.

Until a modern economy takes the plunge and introduces a land tax—and keeps it—it is hard to know if performance will match promise. “It is a question of faith” admits Stuart Adam, of the Institute for Fiscal Studies, a think-tank which backs the idea. Yet until its benefits are convincingly displayed, few politicians will feel like risking the wrath of the landowning lobby. In short, precious little has changed since George was alive.