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## A POLITICAL FIX FOR THE ENGLISH HOUSING CRISIS

Why has there been so little progress on Land Value Taxation in England? With so much impressive moral, ethical and philosophical support for LVT, you'd think that governments would be delighted to bring it in. When economists from Ricardo onwards sing its praises then surely it must be a no-brainer; politicians and administrators should be clamouring to implement it. But no; since as far back as the 1909 People's Budget, LVT has failed to be enacted. If, as I believe, LVT is the best and possibly only way to fix the housing crisis, I am keen to explore what is preventing it. But realism dictates that any proposal to change the tax system has to pass the practical politics test. Will any politician, wanting to be re-elected, stick his or her neck out to promote even a small amount of Land Value Taxation?

### WHAT HOUSING CRISIS? PRICES GONE MAD

Is there a housing crisis? Are houses too expensive, shoddy and too small? Is there a need for many more new houses, better suited to modern lifestyles? Of course there is! Recognising that there is a crisis, politicians love their wheezes claiming to 'help' home-owners, especially first time buyers. Unsurprisingly their schemes always have the same result—prices keep rising, making things worse. Most pundits use the clever throwaway line "To fix the crisis, build more houses!". It is true that once a properly functioning housing market is established, then more newly-built houses and lots of them—millions more—will be the solution. But for now, in today's warped housing market the 'build-more' solution simply cannot work. Instead, what would help the market right now would be a drop in prices. Fix that first and then, in time, as I hope to show, the other features of the crisis—shoddy, poky little homes, and far too few of them—can begin to be addressed.

But are there any popular policy options that might appeal to politicians, which will begin to bring down house-prices? My suggestion is that replacing one unpopular tax — Stamp Duty — with a small Land Value Tax would be both politically practical and bring down house-prices a bit. Once this small change has bedded in, politicians would then feel comfortable switching yet more property taxes to LVT. The hope is that, eventually, as more LVT is introduced house-price levels should come down, so that nearly everyone can afford to buy or rent a home in all parts of England.

I have a lot to establish here. For a start, how could a switch from Stamp Duty to a small LVT be politically popular? If it was enacted, how soon would it have any effect on house-prices?

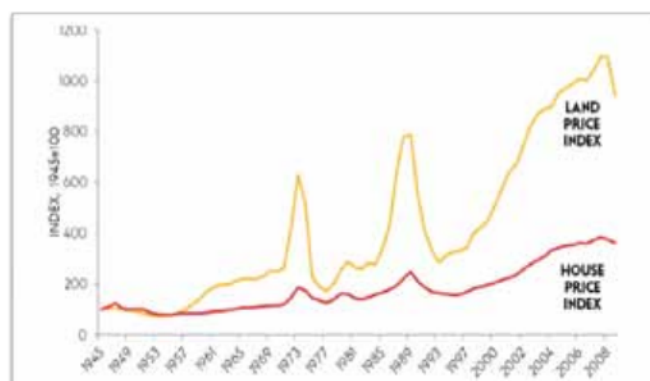
But before I get into the details of my proposal to use LVT to bring down prices, I'd like to review a few basic facts about house-prices and the housing market. This will probably be familiar to most readers of Land&Liberty, but please bear with me! There is a lot of misunderstanding out there about what is *really* causing 'house-price' inflation.

### THE MAIN DRIVER OF HOUSE PRICE INFLATION — LAND

Of course, it's not house prices that are rising. A house is a man-made artefact, and depreciates from the day it is built. What is going up, and nearly always faster than inflation generally, is the price of the land the house stands on.

*Housebuilding Costs:* Currently house-building costs are typically about £1400 per square metre (2018-prices), so a typical 90 m<sup>2</sup> 3-bed semi will cost about £120,000 to build in almost all parts of England. The good news is that this price (adjusted for inflation) has not increased over the years. But the bad news is that unlike, say, cars, televisions or computers it hasn't dropped either, but that's a story for another time.

*Land prices are different:* There is huge variation in the price of a plot of land for housebuilding, and, as we all know, the price depends on its location. Unlike building costs, land prices have been increasing faster than inflation generally, faster even than 'house-price' inflation. This graph illustrates this picture: Despite some ups and downs, the trend in land prices is ever upwards. (The graph can be found in *Rethinking the Economics of Land and Housing* by J. Ryan-Collins, T. Lloyd and L. Macfarlane published 2017).



But it's not just newly-built houses that are affected by this land-price hyper-inflation. The majority of all house-sales (80% or more) are of second-hand properties. Their price is affected by land-values to an even greater extent. Since the house itself cannot be 'worth' more (apart from significant improvements), the only explanation for the huge rises in 'house'-prices is the inflation of the price of the plot of land it stands on.

*How is the price of a plot of land worked out?* Does this sound like a silly question? It's obvious how a loaf of bread, or a television set, or even a haircut gets priced. These things have a cost of production, and a value in use. Land is different. A plot of land generally costs next to nothing to produce and has little intrinsic value apart from its agricultural value. As readers of Land&Liberty well know, it is Society, not the land-owner that creates this price/value in the plot of land. Availability of land is to some extent limited by location; planning restrictions limit the supply of land even more, again societal value creation.

*But how do people manage to pay these ever-inflating prices for the land with a house?* This is where the banking system comes in. Few house-buyers can afford to pay the full asking price, so a loan is needed. Banks, through their privilege to create our money, fund the mortgages that enable the buyers to pay for the land and the house that goes with it. Here's how economist Ryan Collins explains it:

*"Firstly, banks are not, primarily intermediaries: banks create new money when they make loans—as the Bank of England recently made clear—so intermediation is a misleading term. Second, in advanced economies, the main activity that banks engage in is domestic mortgage lending; not business lending. Thus, in the UK today the majority of new money created for the purchase of existing land and housing—existing assets rather than new, productive assets that enable the economy to expand. And given the limited supply of new homes, the result has been systemic house price inflation well beyond the growth of the economy."*

*What is the big incentive to buy?* It is not just the status of 'home-owner' that encourages the majority of the population to mortgage themselves to the hilt to buy a house. There is a much bigger prize at stake. Because house prices always go up, or so it is said, we can all join in this racket, thanks to bank loans secured on the ever-rising value of land. This is the huge attractor, and is the basis for the 'Great Home-Owning Democracy' espoused by Margaret Thatcher. It's all about getting rich on the uplift in value of the land. No effort or merit is required for this capital appreciation; all you need to do is own a piece of land in the right area with a house on it. Then watch your net wealth—house price minus outstanding mortgage—soar.

Three possible ways to fix the cost of land for housing: If the driver of high prices is the inflated cost of the plot of land the houses are built on, how might this cost be taken out of the price of the house? As I see it there are three possible fixes, which should start to take land values out of house prices:

*One way might be to crush the banks' ability to inflate land values through easy mortgage lending.* It's been done before. Prior to the 1970s liberalisation, banks were discouraged from lending on mortgages. It was Building Societies that issued almost all the mortgages, and they were severely restricted, lending only the money they had on deposit. (This is a bit of an over-simplification,

but true in essence). And it worked. As you can see from the graph, house prices remained fairly flat until 1972; then came the first financial liberalisation allowing banks into the mortgage market. More easing of controls on banks followed—as did more house-prices booms.

Governments have been very reluctant to curb the power of the commercial banks to create the money to make loans, especially for mortgages. Even after the Global Financial Crash of 2008 there was a feeble but promising attempt in 2011 to levy a tax on bank deposits but this is gradually being watered down. Instead, the Bank of England's 'emergency' policy of Quantitative Easing has steamed on for ten whole years. The house/land price boom has resumed, fuelled by easy money. Politicians are clearly scared of bringing the banks to account.

*A second way to stop land values rising is for government take over the ownership of the land.* That way the Government could collect all of the ground-rents which are the financial benefit of land-owning. True, this would deprive existing home- and land-owners of their unearned land-wealth appreciation, but it would provide a huge opportunity to reduce other forms of property taxation. But that's Communism! So it is, but it's also how the economic powerhouses of Hong Kong and Singapore work. It may be a colonial legacy, and it might not be fully understood even by the local politicians, but it works very well. There's even a modern-day advocacy of an English 'People's Land Trust' whereby the state or local authorities would gradually acquire the land under all the houses in the country. It would work, but the State owning all the land? That really would be the road to serfdom. What politician would push for such a policy?

But the one fix that I am sure will work is to introduce a Full-Value Land Tax. This way home-owners retain all their rights to use their own land as they wish, but pay an annual 'rent' which reflects all the value that Society has created in the plot. Land Value Tax would, of course, be used firstly, to eliminate all other property taxes.

Home-buyers and sellers will continue to be free to trade their properties in this new full-on LVT world. What they will discover is that the price for a house would be virtually the same in all parts of the country. Brand-new houses would have prices, which reflected their build costs (typically £120,000). Because of normal depreciation, second-hand houses would be cheaper.

In this hypothetical world of full LVT the price of the plots of land would be near zero. Since variations in LVT reflect the community-based value created in the land, in less affluent parts of England the LVT charge would be quite small, less than £100 per year. In suburban London it could be £10,000 a year or more. Although variable, an average LVT should be about £4,000 a year.

As well as reducing and equalising house-prices throughout England I would anticipate further dynamic effects. Freed from the burden of land speculation, the house-builders would start competing to build better houses and more of them. This in turn would energise the private rented sector and even the social housing would benefit too (if it was still needed). This may sound like a 'too-good-to-be-true' fairy-tale, but it happened once before. During the 1930s more houses were built per year in England than any year before or since. These 1930s semis were well built and are still an attractive buy today. Given the right





conditions, mostly cheap land, the house-builders can do it! They can produce good quality housing in abundance at prices almost everyone could afford.

But all this is only a hypothetical scenario. Is there any practical, politically savvy proposal that would be the first step towards this full-LVT world?

Yes. Take one unpopular tax on property and replace it with a small amount of Land Value Tax. When asked the great British public thought that the most unfair tax of the lot is Inheritance Tax. Then going down the unfairness scale came Stamp Duty, TV Licence, Fuel Tax and VAT. Taxes on Cigarettes and Alcohol were deemed 'fair', as was National Insurance and Income Tax. Surprisingly, even Council Tax was felt to be fair-ish, which should be a warning of the political pitfalls in store for those wanting to switch it to LVT.

So would getting rid 'Death Duties' — Inheritance Tax (IHT is the usual abbreviation), be the canniest political move? IHT is certainly the most hated tax, so a switch to LVT might be easy. I will make a suggestion for abolishing IHT later on, but for now I'll stick with Stamp Duty or Stamp Duty Land Tax (SDLT) to give it its full official name in England. This should be the easiest tax to abolish and switch to LVT. As a bonus it has 'Land Tax' in its name!

The politics of SDLT: In an odd way Stamp Duty (SDLT) is 'voluntary' — you only pay SDLT if you choose to buy a house. SDLT also seems 'fair' because it attaches to a sum of money, which is changing hands. The Chancellor of the Exchequer gets away with it because, at any one time, not so many voters are hit by SDLT. Only one or two million houses are bought each year, so only about two or three million voters get hit by SDLT. Chancellor Osborne (2010-2016) was particularly cavalier with SDLT, changing the rates frequently, and gaining political kudos by imposing draconian rates on buy-to-lets and million-pound plus mansions. Unlike Thatcher's Poll Tax in the 1990s, there were no mass protests in the streets against these steep rises in the top rates of SDLT.

The Economics of SDLT: Because it is paid up-front, house-buyers lose out. This discourages sellers too, with fewer houses being put on the market. Employment Economists have identified SDLT as drag on the job-market, stifling transactions. In their ideal world, workers would face few impediments to moving to where the jobs are. If this involves selling your house and buying another, then this tax discourages the free movement of labour. Since SDLT is imposed every time a house is bought, this is especially onerous on those heroes of the flexible labour market, the frequent job-changers and movers.

So SDLT is both unpopular politically and a tax, which badly warps market incentives. It is ripe for reform or replacement, but abolishing altogether would mean losing a very traditional, long-accepted tax.

How best to bring in the new mini-LVT: At the next Budget it would be a straightforward to announce: *"As from next May 1st domestic property transfers will no longer be subject to Stamp Duty. Instead, there will be an annual levy on the land-value of the property of one-third of one percent."* The proposed mini-LVT replacement would, like SDLT, be a 'voluntary' tax, and would be a clean break with the old Stamp Duty. There would be no need for



parallel trialling. So the campaign slogan to sell the change might be *"House-buyers: Don't pay a big lump of SDLT now. Spread your payments out as a yearly charge of just one-third of one percent of the value of the plot of land your house is built on."*

The first pseudo-problem that critics will jump on is: 'How do you value land separately from the house standing on that plot of land? And what about flats, etc.?' I used to teach real estate valuers, and I can tell you that they are perfectly competent and have years of experience and knowledge to do such valuations. Since the Land Registry will still be notified of all transfers, they, in collaboration with professional bodies like the Royal Institution of Chartered Surveyors could swiftly agree a protocol for calculating land values for 99% of cases, including apartments in blocks. The tiny remnant of difficult cases could be resolved through a Tribunal. Modern Data Analysis will help, too.

Where did I get the figure of one-third of a percent of the land value? We can assume that the Chancellor of the Exchequer aims to be 'revenue neutral', and generate as much in tax revenue (about £8.5 billion) from the new mini-LVT as the old Stamp Duty before. By my estimate a third of one percent levy on the value of the land would soon produce the same revenue stream as before.

*How will the new annual LVT be paid?* Stamp Duty is a national tax, so it would be reasonable to continue this, and make use of the usual income tax arrangements: LVT might mean no more than an adjustment in PAYE allowances. In this way the payment of LVT is just another deduction in the monthly tax bill. Voters are far more aware of, and likely to complain about, any one-off tax demand. It is good politics to have taxes paid as a small steady amount.

#### AVOIDING THE PITFALLS

*Annual Re-valuation of Land Value* Politicians might give less prominence to the fact that this would be a dynamic tax. The land-values would be subject to annual re-rating. Allowing several years if not decades before revaluation has been a major failing with many previous property tax systems. Politicians, in a state of funk 'postpone' the re-valuation, leaving an even worse problem for those who come after them. With the help of modern computer-based valuation techniques, annual re-valuations of all land-values would be easy and cheap to implement.

One positive implication of regular revaluations of land values could be a reduction in your LVT bill if local economic conditions worsen. On the other hand, home-owners who faced a major hike in their LVT charge because a new high-speed transport link was proposed nearby would be less pleased. It's good politics to make these changes up or down in the smallest possible steps. In this way the new LVT becomes a dynamic tax, based on current, local economic conditions: Crucial in sending the right market signals.

**Winners and Losers:** To make any new tax easier to sell, politicians often look for some means to compensate the losers. In the case of the new LVT might it be advisable to add on allowances or exemptions? Maybe there isn't a problem. As I've said, this is a 'voluntary' tax. If you don't want to pay it, then don't buy a house or flat. Since the new LVT is a straight replacement for the old Stamp Duty there will be no need for parallel running while bringing it in. But is that enough, politically? Can we rely on home-buyers forgetting how the old SDLT worked? It was steeply progressive. A property costing less than £125,000 paid no Stamp Duty; to buy a million pound mansion in Chelsea would once have cost at 10s of £1,000s in SDLT.



This might become a political 'bear trap'. A very modest proposal to investigate land-value taxation by Labour in 2017 General Election had the rabid right-wing press furious. Now imagine what they would say about my scheme: "Getting rid of Stamp Duty is just the first step towards Garden Tax". If we do nothing to compensate losers, perhaps the fuss will soon die down. It's new, and even for the losers it won't cost much: £50 or £100 per year, scarcely visible when paid as an income tax deduction. Home-owners will soon forget that strange old beast that used to be called Stamp Duty, and anyway people have short memories for this sort of technical detail.

How the new mini-LVT will bring down house prices The whole point of embarking on the political peril of ditching Stamp Duty and replacing it with a small LVT is to drive down House Prices. So will a little bit of LVT do the trick? How would it work, and by how much will prices fall?

First off are the benefits of abolishing an economically damaging tax. If Stamp Duty (SDLT) was abolished, according to one report an additional 45,000 property-owners would be encouraged to put their houses on the market. Another report is even more positive. Abolition of Stamp Duty should result in between 80,000 and 200,000 more houses on the market. More sellers will increase the supply of houses, which should result in house-prices coming down a bit. If this new, small LVT was to be extended to the housebuilders' landbanks, this would create another nudge for them to get on and build.

Secondly, LVT will bear down directly on land prices. Economic theory says that the rational reaction of the house-buyer should be to calculate that something like 10% of the Land Value has been taxed away in perpetuity by LVT, so the 'House Price' (in the new reality it's the building value + 90% of the Land Value) should be marked down. Instead, the 'irrational' house-buyers might be tempted to think "By not paying Stamp Duty I've got a bit more money to play with for now, so I can bid a bit higher." Normal human beings don't behave in the ways economists predict.

Quite soon though, the penny will drop. The mortgage lenders, who *should* act rationally, will be well aware of the reduced equity caused by this partial LVT. If they don't, then maybe the regulators will remind them, forcibly, by requiring the lenders to offer less by way of mortgage. Purchasers of property may be enthused at the lower pay-outs at the time of purchase, but it is the job of the lenders to curb their enthusiasm.

### THE FINAL ACT

As the years roll by and more houses are sold and bought, so yet more properties will be scooped up into this new mini-LVT net. The scope of mini-LVT can be extended in other ways too. Including property, which is transferred, free of charge, which at present attracts zero Stamp Duty, is one example. Then, after maybe ten or fifteen years, this mini-LVT it might apply to as many as three-quarters of all homes. It would then look odd that the remaining quarter of properties were tax-free. This would be the point when governments could include all properties in the mini-LVT net. (This was the technique used by governments to abolish tax relief on mortgage interest payments; it took more than 15 years to reduce it in slices, but in the end there was little complaint at its total abolition).

Of course the final act will catch home-owners who not moved for a long time—typically those symbolic victims, the lone elderly

living on in a large family home. It is usual for proponents of LVT to offer some kind of exemption or exclusion for these hard cases.

Or maybe we could do something a bit cleverer, which would be attractive to these long-stayers. We could make them an offer, which would be attractive to the property-rich, cash-poor: Invite such householders to be included in a higher rate LVT, but in return for exemption from Inheritance Tax and Capital Gains Tax. An attractive offer would be exemption from the 'Dementia Tax' (the confiscation of nearly all your property wealth to pay for your long-term stay in a care home). Just like the process of converting Stamp Duty into a small amount of LVT, these elective conversions will get home-owners familiar with the bargain. In time this could be expanded to include all home-owners.

The final step: Turn Council Tax into an LVT. This is a large and highly salient tax on property. It ripe for conversion to LVT, and for many Georgists it is the first tax they would like to convert. But this is a political minefield. English local property tax has gone through changes from the Domestic Rates, through Poll Tax and now Council Tax (CT). The charging system is highly politicised. But CT is important because it generates a significant amount of revenue. For this reason, I'd say that this should be the last tax to convert. In the long run, as home-owners get used to the LVT system they are then more likely to accept such a switch. By that time the real benefit of LVT — the emergence of a plentiful supply of good, cheap housing — will encourage them to welcome the final switch from Council Tax.

### WHAT HAS BEEN ACHIEVED BY THIS PROCESS?

It may have taken 15 or 20 years in my scenario just to complete the final switchover from Stamp Duty to a small Land Value Tax. Limiting my proposals to what is politically possible may seem craven, but does anyone remember all those post-WW2 attempts to capture the windfall gains from the grant of Planning Permission? The history of the Betterment Levy as it was sometimes called is instructive. First it was imposed by one government (usually Labour), then dumped when the alternative (Tory) party took power. This happened several times. All that remains now is the inherently corrupt 'Section 106 agreements' as a feeble attempt to capture windfall gains of landowners obtaining planning permission. By using a slow but sure means to introduce a small rate of LVT, it should stable enough to withstand changes of government.

A crucial advantage to the introduction of this small but continuing LVT is that the mechanisms and definitions for 'land value' become established. Beginning with a small number of cases, the methodology for valuation of the land under an existing house can be securely established. The general public, too, will become familiar with the concept of land value, and start to make more sane judgements about house prices, being as they are an amalgam of the depreciated value of the building and the societally-created value of the land it sits on. These are vital understandings that need to be brought home to the widest possible number of the electorate.

But what of my original claim to fix the English housing market, to make houses cheap and plentiful, and of superior quality? I am confident that once the initial slice of LVT is established and its beneficial effects take hold, voters will be clamouring for the politicians to replace all property taxes by LVT. It may take decades to get there, but we need to find an immediate political way to start on LVT. ■