

**FRED HARRISON warns:**

# Unless politicians confront land issue they will always fail



● Fred Harrison

**P**OLITICIANS, no matter how else they may have disappointed their constituents, believe that in one area they have been eminently successful: making it possible for people to own their homes.

Throughout the Western World, the proportion of owner-occupation in the housing market has increased from under 40 per cent in the 1940s to 60 per cent and more today.

This achievement is deemed to justify considerable self-congratulation. Unfortunately, a number of facts are overlooked which lead us to this indictment:

*Politicians in general are guilty of thwarting the aspirations of their constituents who want better homes for their families.*

- As house prices have escalated, families have had to pay off their mortgages over a longer period, or repayments have taken up a larger proportion of incomes; and
- Far more families could have bought their homes, if the housing industry had been free to meet the demand with houses at prices which people could afford.

This one area of social and economic policy, far from notching up commendable gains for society, can be regarded as a singular failure when measured against the potential achievements.

Ironically, however, electorates in all the industrialised countries – except Japan – have raised no significant criticisms against the track records of their governments.

The reason for this can be stated quite simply: a confusion over their real interests and general ignorance of the way in which official policies have worked against them.

The evidence from the United States and Canada enables us to focus on the main problem in the housing market – and the way in which it is further aggravated by the political system.

**T**HE HOUSING sector has been the subject of exhaustive investigation. *Each report has concluded that the single major obstacle to a more efficient industry has been the supply and price of land.*

- In the United States, for example, two Presidential commissions (the Douglas and Kaiser Commissions) published reports in 1968 that noted how the land component was increasing more rapidly than total costs, a phenomenon which continued into the 1970s (Table I).
- In Canada, the authoritative report was produced by the Task Force on Housing and Urban Development in 1969, which drew a similar conclusion.

Gary Sands, in a new book that usefully summarises the evidence, spotlights the major defect in these official reports:

*"The commissions' recommendations placed little emphasis on land-development issues. Rather, they emphasised the affordability issue, with major consideration given to increasing affordability by making mortgage terms more liberal and by subsidising mortgage interest rates."*

This neatly reflects all that we need to know about the thrust of policy. Governments have passively accepted the housing market conditions as they are, and have sought to help people to overcome the obstacles to owning their homes.

But in what way has this heightened the obstacles over which families have had to jump before they could get the keys to the front doors of their homes? The answer emerges in the research by Sands into the housing markets of four cities – Calgary and Edmonton in Canada, and Houston and Phoenix in the U.S.

TABLE I – UNITED STATES: COMPONENTS OF HOUSING PRICE

	1949	1969	1974	1977
Structure	69.0%	54.6%	48.4%	46.7%
Land	11.0	21.4	24.6	25.0
Financing	5.0	7.0	10.0	10.8
Other	15.0	17.0	17.0	17.5

An elementary knowledge of the Ricardian theory of economic rent yields the hypothesis that, if special tax and interest rate concessions are granted to potential buyers, these will be capitalised into higher prices for raw land.

*This is because land monopolists, who command a resource that is in fixed supply, wield a greater power than the suppliers of the materials that are used to build houses.*

So we would expect the price of land to rise at a faster rate than the cost of new houses. This is borne out by the prices that have been monitored in Calgary and Edmonton (Table II).

The result, as Sands notes, is that fewer single-family homes are built, and people are forced to accept greater-densities (multi-family owner occupied units) or rented accommodation.

This is an outcome that is the diametric opposite to what the politicians claim that they want to achieve. Yet the unambiguous result is that families are compelled to

settle for second-best, giving rise to an increase in slums and consumer dissatisfaction.

**T**HIS GENERAL outcome, however, would occur even if governments did not aggravate the situation with their self-defeating policies.

For the major problem, stated simply, is that land speculation has the greatest de-stabilising effect on the housing industry – and is the biggest hurdle that has to be jumped in the pursuit of a decent home.

Sands quotes one study which concluded that, without the intervention of land speculation, houses that sell for \$65,000 in the large cities could be priced at \$15,000 to \$24,000 less. Another study shows that speculative gains amounted to 20-30 per cent of the sales price.

It goes without saying that there is considerable scope for cutting house prices, and thereby drawing a large number of poorly-housed low-income families into the owner-occupier bracket.

Sands reviews some policies for dealing with the problem of high land prices. He finds them unsatisfactory.

● **Land banks.** A number of countries have tried to handle the problem through public sector action.<sup>2</sup> Land is released on to the market at prices near its agricultural value, in the hope of keeping down the sale price of the house.

But a substantial land bank in Edmonton has not succeeded in lowering the prices of building plots. And there is another snag with this policy, as Sands notes:

"A below-market-priced lot sold from a public land bank provides the initial purchaser with the opportunity for a substantial capital gain, at the expense of the community."<sup>3</sup>

● **Capital gains tax.** Sands argues that a full capture of all the capital gains on residential property is not a practical solution, but he appears to rule it out, in the main, on the grounds that it is contrary to current policy.

The serious difficulty with a capital gains tax is that it would encourage rigidity in the housing market. At a time when labour mobility is crucial for the economy, the prospect of losing a considerable sum of money by selling one's house is a powerful incentive to stay put – despite the fact that employment prospects are better elsewhere. And there is always the hope that, with a change in government, the tax might be removed.

● **Land value taxation.** This fiscal policy – a tax on the annual value of land in its unimproved state – is ignored by Sands. Yet this is the tax that (without distorting the housing market in any way), is necessary to achieve this objective:

"If home prices are high largely because of speculation, actual price reductions are most likely to occur only if the speculative element is eliminated entirely."<sup>4</sup>

**I**N PROPOSING the total elimination of speculative profits, one has to recognise that this would be – in the first instance, at any rate – a politically unpopular proposal.

In Canada, people buy more than a home for their family: they see the roof over their heads as an investment. They speculate in the prospect of capital gains. "The purchase decision is keyed to the eventual resale of the property – the higher the anticipated resale price, the more an investor is willing to pay to acquire the property. Simply put, even at high prices, single-family homes and residential land represent a good investment."<sup>5</sup>

Yet this policy is also self-defeating. For the "something-for-nothing" psychology which dictates the price that a person is willing to pay for a house can have serious, unintended effects on his family.

The most serious risk is that, by inflating the price of land to artificial levels, he is helping to de-stabilise the building industry; and that, as we now know, has a direct effect on the economy in general.<sup>6</sup> *When the building industry goes into decline, as it did in Canada three years ago, a general recession follows within 24 months.*

Today, ten per cent of the Canadian workforce is out of work. This is the highest unemployment rate since the Depression of the 1930s. The owner-occupier who is sitting on a high-priced plot of land is no less vulnerable to redundancy from a loss-making company – and the traumas of unemployment – than the worker who lives in rented accommodation.

And is the speculative investment in one's house worth it in the end, anyway? Unless a home-owner plans to "trade down" to something cheaper, he will not enjoy the cash benefits of the escalating price of his asset.

On the other hand, by "trading up", he is usually obliged – when confronted with escalating land prices – to pay a larger proportion of his salary to finance a new mortgage. This means that his family's living standard, measured in terms of consumption power, is diminished.

Once this scenario is presented in a systematic way, the wisdom of eliminating land speculation completely is likely to find favour with a significant constituency; and this, in turn, would have a salutary effect on the policy-formation of politicians aspiring to power.

#### REFERENCES

- <sup>1</sup> Gary Sands, *Land Office Business*, Lexington: D.C. Heath, 1982, £15.
- <sup>2</sup> Ann L. Strong, *Land Banking: European Reality, American Prospect*, Baltimore: John Hopkins UP, 1979.
- <sup>3</sup> Op. cit., p. 130.
- <sup>4</sup> *Ibid.*
- <sup>5</sup> *Ibid.*, p. 127.
- <sup>6</sup> Fred Harrison, 'How to build our way out of the recession', *Land & Liberty*, May-June 1982.

TABLE II – CANADA: NEW-HOUSING PRICE INDEXES

Year	Calgary			Edmonton		
	Total	House Only	Land Only	Total	House Only	Land Only
1969	36.9	43.3	24.3	37.0	42.1	24.9
1970	38.3	45.5	24.4	39.0	43.4	28.7
1971	41.2	48.0	27.8	40.7	44.5	31.8
1972	45.3	53.2	30.0	44.4	47.5	37.0
1973	52.0	61.3	33.9	53.9	57.8	45.0
1974	66.8	76.0	48.9	70.3	74.6	60.3
1975	80.4	86.7	68.2	83.5	85.4	79.2
1976	100.0	100.0	100.0	100.0	100.0	100.0
1977	106.9	105.9	108.9	106.9	103.9	113.8
1978	115.5	113.8	118.7	114.3	109.1	126.5

Source: Statistics Canada, "Construction Price Statistics: New Housing Price Indexes – Supplementary Information" (mimeographed). (Ottawa: 1979).