Property: Land of opportunity

by Robin Harding

To its advocates, land value tax has almost magical powers. Has its moment finally come?

The Brace & Limb building stands at 1125 Ninth Street in the small city of Altoona in central Pennsylvania. Its three modest storeys are handsome enough, though the architecture is not remarkable. However, in one respect it is the most interesting piece of property in the US.

The red-brick building is part of a bold experiment in tax policy – one that could boost the housing supply, stimulate economic growth and make property markets fairer across the world.

During the past decade, Altoona has become the only city in the US to fully adopt a revolutionary form of finance: a land value tax. In Altoona, only land – not the buildings standing on it or the people inside them – attracts a tax bill.

Randy Green, the cheerful young entrepreneur who is converting the building into apartments, says LVT is part of the reason his investment makes sense. "That is a factor here," he says. "You can put $175k into making it nice and you're not going to see a rise in tax. That's a plus."

For almost two centuries, economists on the left and right have regarded LVT as the best of all possible taxes, with almost magical powers of equity and efficiency. It was conservative hero Milton Friedman's favourite tax, yet promoted just as often by socialists, with the latest echo in this week's Labour party proposals for a "mansion tax" in the UK.

The trouble is that land taxes rarely last. Altoona began phasing in its tax in 2002, but is already debating whether to repeal or roll it back, like other jurisdictions – from New Zealand to Pittsburgh – where the idea has been tried. Altoona shows hints of the magic, but is also a case study in the political and practical obstacles to LVT fulfilling its promise.

"My prediction right now is that it may roll back 50 per cent towards the traditional version, rather than go 100 per cent one way or 100 per cent the other," says Dave Butterbaugh, a city councillor who has concerns about the tax.

"Land value tax – I think the jury is pretty well out on that," says Peter Marshall, the interim city manager in Altoona. "I don't know you can look at Altoona and decide if it has motivated people to improve their properties. I don't know if it has."

The story of the tax goes back to the great classical economists Adam Smith, and David Ricardo. Ricardo not only made a fortune in the City of London – he was holding a year's worth of British government bonds when Napoleon lost at Waterloo – but also invented chunks of economic theory, including a profound analysis of land.

Ricardo's basic insight is well understood by estate agents everywhere: some land is better than other land and nobody can make any more of it.

Thus whenever the economy grows, part of the benefit goes to owners of land. Another of LVT's many historical advocates was Mark Twain, who is said to have advised: "Buy land, they're not making it any more."

Because nobody makes land there are unique results when you tax it. LVT is the only tax that does not distort economic activity at all. If you tax wages, people work less; if you tax capital, they invest less; but if you tax land there is still just as much land as before.

This is why Altoona bought into LVT. "What they wanted to do was establish a land value tax so people would be encouraged to develop or improve what they have," says Mr Butterbaugh.

But efficiency is not the only argument for LVT. In 1879, the American journalist and campaigner Henry George wrote Poverty and Progress, a book that turned Ricardo's insight into a moral and political cause.

George argued that land taxes are just. Nobody made the land; land becomes valuable only when a community turns it to productive use, so George argued that its earnings should go to society in place of all other taxes.

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– Winston Churchill, another fan of LVT, in 1909.

He ignited a campaign that did not abate until the first world war. "Roads are made, streets are made, services are improved, electric light turns night into day... and all the while the landlord sits still," said Winston Churchill, another fan of LVT, in 1909. "He renders no service to the community, he contributes nothing to the general welfare, he contributes nothing to the process from which his own enrichment is derived."

These arguments have new resonance today, as house prices soar in big cities, creating much of the wealth documented by French economist Thomas Piketty. And LVT has more advantages. You cannot move land, so you cannot dodge the tax. It also creates a powerful incentive to use land to the full, thus boosting the supply of houses.

To its fans, LVT cures all ills. Yet they need to wrestle with the reasons why it is still little used after 200 years. Altoona shows the obstacles – most notably the difficult politics of LVT – but also offers some lessons in how to make it succeed.

Altoona grew up around the spot where engineers at the Pennsylvania Railroad found a way across the Allegheny Mountains. Even today, coal trains snake around the horseshoe of a side valley, slowly gaining the elevation needed to crest the ridge.

The railroad made Altoona rich. Pictures from 100 years ago show a bustling city built around its rail yards. But the railroad began to decline in the 1930s, and Altoona declined with it. Today it is another small city in Appalachia, doing better than many, but no boomtown.

Part of the problem is Altoona's leaders had unrealistic expectations.

LVT was never going to ignite a construction boom. There are fine art-deco structures vacant and boarded up because, as in many post-industrial cities, demand is modest at any price. Altoona is using LVT in a city where neither land nor buildings have much value.

Joshua Vincent, executive director of the Center for the Study of Economics in Philadelphia, is a modern-day disciple of Henry George. He has been involved with Altoona's LVT from the start and pushed similar efforts in other Pennsylvania cities. Scrapping tax on buildings has at least ended the owners' incentive to let them fall down, he says.

"The regular property tax encourages disinvestment and so it encourages blight and depopulation," says Mr Vincent. "I believe that the land tax has had some role in slowing the bleeding." The city's level of construction may be low, he says, but Altoona is taking a larger share of investment in its local area.

Mr Vincent points out several other benefits to Altoona. The city collects almost \$1m a year from vacant lots under the LVT, compared with the \$122,000 it would get under the old system that mainly taxed buildings. About 73 per cent of households pay less under the LVT than they otherwise would.

The big political problem is that these households do not notice the tax cut – most people in Altoona seem oblivious to LVT – but commercial landowners, such as car dealers, feel the tax acutely.

Richard Johnston, an Altoona real estate agent, points out an empty 2½ acre parcel of hillside land. The out-of-town owner is desperately trying to sell after his annual taxes trebled when LVT moved the burden on to land. "He can't even get $20,000 for the property," says Mr Johnston.

To proponents of LVT this is a feature and not a bug – penalising idle land is what the tax is all about. To Mr Johnston and many in the Altoona business community, however, it is unfair. The owner is being taxed heavily on land that earns nothing, while big buildings pay little.

These perceptions of unfairness are the main threat to LVT. Bill Schirf, a former mayor, has a different problem. Like a lot of people in the city, he bought an empty or abandoned lot next to his house and used it to expand his yard.

"We have a lot of these side lots. I have one side lot and one irregular, and my taxes went up 200-300 per cent on these little side lots," he says. "A lot of these houses are on 25ft lots and when you tear one down, who's going to build a new home when the houses beside you are worth $40,000 or $50,000?"

That points to a problem Altoona has had with land tax: out-of-date property valuations. Blair County, where Altoona sits, last revalued property in 1958. Mr Schirf's side lots are taxed as if he could build a house on them, whereas in reality they have little market value.

The problem of valuation goes deep: it matters what you can do with the land. In suburban London, for example, or in Palo Alto, California, a plot has one value with an existing house on it and a much higher value if you can knock it down and build apartments. Use the value as is, and LVT turns into a house tax. Use the higher potential value and there is a strong incentive to develop, but great unfairness if planning rules prohibit it.

"I've never really thought it's politically feasible to have land-only tax on houses – it would immediately be branded a tax on gardens," says John Muellbauer of Nuffield College, Oxford.

All this adds up to a set of conditions for a successful LVT: modest expectations, public acceptance that taxing land is fair, accurate and up-to-date valuations, and sufficient freedom to reuse land in different ways.

Mr Muellbauer says the obvious target for LVT is commercial property. Ed Glaeser, a professor of economics at Harvard University, agrees. "Things that really appeal to me are putting heavy taxes on brownfield sites or parking lots," says Mr Glaeser. "I would be targeting it to areas where it's possible to get a supply response."

Incremental moves towards LVT are also possible. In the UK, for example, a first step would be switching from residents paying tax, as under the existing council tax, to the US system of taxing the owner. Another option is public land banks, which buy undeveloped land then capture the increase in value when permission to build is granted.

With investors pouring cash into a few global cities and tight limits on supply, the pressure for a tax response will not go away. "The global super-rich are using London and the southeast of England as a kind of bank vault," says Mr Muellbauer.

Back in Altoona, officials say they are leaning towards a compromise on LVT, but much will depend on what happens when Blair County finally revalues local property. Historically, that has been a perilous time for LVT – Pittsburgh's version died in 2001 when it unfairly got the blame for a jump in tax bills.

After 200 years, though, the beautiful idea of land value tax may be near its moment. If so, a small railroad town in the heart of Pennsylvania will have helped to show the way.

Bubbles: Land values are clearest sign of a looming crash

One of the big practical issues with land value tax is getting accurate valuations, writes Robin Harding. But the rise of big data, along with renewed academic interest in land markets after the 2007 housing crash, is making that more feasible.

In a recent paper, Morris Davis of Rutgers Business School and co-authors Stephen Oliner and Edward Pinto at the American Enterprise Institute, calculated values for the land under 600,000 houses in Washington DC since 2000.

They argue that land prices – which are much more volatile than the price of houses – provide a useful warning signal about the danger of a house price crash. To get the land valuations, they combine the sale price for individual houses with databases about construction costs and the size of housing plots.

The pattern they observe in Washington DC is striking. During the boom from 2000 to 2006, land prices jumped by 500 per cent in poorer areas of the city – where it made up a smaller portion of the starting value of a house – while the rise in more affluent suburbs was just 200 per cent.

That added up to similar rises in overall house prices across the city.

In the crash, the pattern was different. Land prices fell by 20 per cent from their peak in affluent areas and 75 per cent in poorer neighbourhoods, but this time overall house prices mirrored the land prices, with a much bigger drop in the less affluent areas. "This implies that an explosive rise in land prices, even when not accompanied by a relatively large increase in house prices, provided a valuable signal about the risk of a severe house-price drop," the paper says.

With the International Monetary Fund warning about housing risks there is demand for such indicators.

Shifting some of the tax burden to land, meanwhile – whether via LVT or more traditional techniques – could help to stabilise a sector that has been at the root of boom and bust cycles over the past 30 years.

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"A tax on rent falls wholly on the landlord. There are no means by which he can shift the burden upon anyone else. It does not affect the value or price of agricultural produce, for this is determined by the cost of production in the most unfavourable circumstances, and in those circumstances, as we have so often demonstrated, no rent is paid. A tax on rent, therefore, has no effect other than its obvious one. It merely takes so much from the landlord and transfers it to the State."

– John Stuart Mill, (1806 - 1873) English philosopher, social reformer and major 19th Century intellectual figure.