

Land tax is something to build on

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How should one finance infrastructure? How should one decide what infrastructure to build? The answer to these two questions would appear self-evident: we should build infrastructure if benefits exceed the cost and we should finance it by taxing the beneficiaries.

Who are those beneficiaries? Landowners is the answer. Land taxation is the natural, efficient and just way to finance the capital cost of infrastructure. That is the point of a thought-provoking pamphlet by Fred Harrison, research director of the Land Research Trust.*

Consider a simple example. In a busy town the average house price is £300,000, of which half is the cost of building (or replacing) the house and the rest the value of the land. Some way away is an isolated village. Here the identical house costs £200,000, of which just £50,000 is the land value.

Consider what would happen if a road were built, for the first time, between the town and the village. Residents of the town would want to move to the village to take advantage of the cheap houses and the amenities. Assume, for simplicity's sake, that the benefit of the village's amenities to the marginal movers offsets the cost of the extra time they would spend travelling. The price of village houses must jump by £100,000.

Owners of the village housing will capture the benefit of taxpayer-funded road-building. To them this will be a massive windfall gain. In general, the rise in the price of land will account for most, if not all, of the capitalised value of the surplus of benefits over costs to users of the infrastructure.

Often, as Mr Harrison shows, the benefit-cost ratio for infrastructure

that improves accessibility of cities or mobility within them is very large. London's Jubilee line cost £3.4bn to build, but raised land values in adjoining areas by close to £14bn. The benefits were evidently enormous. The same, no doubt, would be true of Crossrail, the endlessly postponed west-east rail link across London. The government's 10-year transport plan would be another example: the cost was estimated at £180bn, but the gains to landowners might be far bigger.

Thus, increases in land values give not only a good indication of the benefits of infrastructure investments, but also provide an efficient and just way of financing their costs. It is efficient to tax these values because the tax would reduce the size of a windfall, while other taxes used to pay for infrastructure reduce effort, penalise the division of labour or discourage capital accumulation. It is also just, because the chief beneficiaries would bear the cost.

It is possible to charge users of infrastructure, as well. Where there is congestion or there are variable costs, such user charges are appropriate. But relying only on user pricing is undesirable if the infrastructure is then under-used. Often it is technically infeasible, as well: road use has long been an example.

William Vickrey, the Nobel-laureate economist, was an exponent of charging landowners: thus "equity and efficiency are both served", he argued, "by having landlords contribute to the network costs of the services so as to enable their prices to be brought closer to marginal costs. In the long run, the increased efficiency of the local economy would tend to redound to the benefit of the landlords by raising their market rents by more than the subsidy."

The use of the rise in the price of land as a means of defraying the cost of investment in infrastructure is easy when, as in Hong Kong, the government owns the ground. A monopoly private owner would also be able to internalise the benefits of the infrastructure investments he makes.

In the UK, however, such voluntary methods would fail because of the incentives for enjoying a free ride on investments made by others. That is why a land tax related to site value is the simplest way of extracting benefits from large-scale public investment.

The generation of data on land values is not impossible: Denmark has done it for 80 years. A simple way of financing local infrastructure would then be via a tax on site values. The revenue could go, in whole or in part, to the relevant local authorities. If the latter were also deprived of the right to vary the rate, they would have an incentive to make investments that raise land values and increase their revenue.

At present, however, the lack of any easy means of raising finance is proving a huge obstacle to desirable investments. Then, when investment does take place, as with the Jubilee line, it merely pours vast windfall gains on landowners at the expense of taxpayers. The result has been a long history of inadequate investment and undue reliance on inherently damaging and unjust taxation. The UK is choking on the inadequacy of its own infrastructure. The time to make a change is now.