

Making Land Work: Towards a Fiscal Solution to Housing Problems

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House Prices are rising steeply in urban centres like Auckland and Christchurch. Discuss whether there is a case for Government intervention in the housing market. If so, suggest a policy intervention and evaluate the pros and cons. If not, evaluate the pros and cons of the status quo.

According to the latest data, the housing market in Auckland remains extraordinarily heated with the average house price rising by 17% in the last year and 5.5% in the last three months alone (Gibson, 2015). Despite the fact that, unlike countries like the United States, Ireland or Spain, Auckland's market did not experience a significant correction in during the global financial crisis¹, the property values have risen by over 50% since 2007 (ibid.). This seemingly unstoppable and steep increase in house prices in New Zealand's economic capital has provoked countless debates and raised serious concerns over the negative impact of the current trends on the country's financial stability (OECD, 2015), economic growth ("Auckland house prices a risk to growing economy," 2014), equality and socio-economic well-being (Johnson, 2012; OECD, 2015). In response to what is increasingly seen as a "housing crisis" (e.g. Miller, 2015), the government has proposed a number of solutions that include dedicating more state-owned land for housing (Rutherford & Moir, 2015), constructing more dwellings and making regulatory changes aimed at increasing the supply of new houses (Auckland Council, 2015). According to critics, such solutions are unlikely to significantly mitigate the situation as they fail to address the more fundamental drivers of the current boom (e.g. Gould, 2015). Similarly, putting aside the issue of housing affordability, such solutions are unlikely to solve the issue of continuous urban sprawl that results in significant environmental, infrastructural and socio-economic problems.

This essay takes a different approach to the current situation. It proposes that the fundamental solution to the issues of both housing unaffordability and the largely unsustainable and inefficient urban structure of many cities in New Zealand lies in removing some of the legal and fiscal privileges enjoyed by land owners. Consequently, this paper argues that the government should consider increasing taxation of unimproved land values. In contrast to capital gains or current property taxes, a simple land value tax could not only limit speculation, or increase housing affordability, but it could also pave the way for a more economically efficient, environmentally sustainable and equitable use of our natural resources.

In order to understand the nature of the current problems and how to solve them is important to acknowledge that "the value of privately held land increases as a result of public investments in infrastructure, publicly approved changes in land use, or broader changes in the community such as population growth" (Walters 2012, p. 5). The high value of land in Auckland results from the government's successful policies, legislation and expenditure on vital infrastructure (such as roads, public transport, water supply), public services (such as justice, security, education) - as well as from the effort and entrepreneurship of Auckland's and New Zealand's workers and businessmen. This is why, in the absence of any significant fiscal policies aimed at capturing some of this

¹ According to Grant Spencer, back in 2007 New Zealand's housing market experienced only a relatively benign fall [of around 10%] compared with some countries, such as the United States, Spain and Ireland, where house prices fell by 30 to 40 percent" (Spencer, 2013).

value, land is seen as such an attractive investment (Harrison, 2006). Unlike genuine capital, land does not depreciate or require maintenance from its owner. Its value is created by public expenditures financed through taxes collected from the working members of the community. Consequently, it only seems just that at least some part of the very high and constantly rising value of the land should be recaptured by the community for the benefit of all residents. The question is how to do so “with fairness and without destroying the incentive to work and invest” (Wetzel, 2004).

Some countries have tried land redistribution programs (Harris, 1969, p. 50; Lissner, 1957, p. 431). Others, such as the South Pacific microstates (e.g. the Cook Islands), have tried to enforce equality in land ownership through making it illegal for anyone to sell or gift his or her land (AusAID, 2008; Ingram, 2004). The problem with the land redistribution approach is that it tends to merely create a new class of landowners and thus continue to exclude landless citizens from enjoying the benefits to which all are entitled (Wetzel, 2004). The issues with the South Pacific approach is that it creates serious obstacles to growth and development, puts a lot of land out of use and ignores the fact that land values’ increases vary across the country, regardless of how small it is (Crocombe, Tongia, & Araitia 2008 and Levi & Boydell 2003). A simple tax on the unimproved land² values (the Land Value Tax or LVT) is a far more economically efficient and fair way of making everybody benefit from community-created increases in land values.

As Joseph Stiglitz (2014, p.8), a Nobel Laureate³ and one of the best known advocates for LVT⁴, notes: “One of the general principles of taxation is that one should tax factors that are inelastic in supply, since there are no adverse supply side effects. Land does not disappear when it is taxed”.⁵ As when it comes to land the elasticity of supply is very low (if any) and as only windfall profits are affected by taxes on land values, the fiscal dead weight loss is minimal with such taxes. Unlike the more common property tax, the LVT is a tax that falls on the value of the land only. In consequence, it not only does not punish land users for any improvements they might make on their sites (i.e. houses, office buildings, gardens, etc.), but in fact adds a cost to keeping land idle. Rybeck (2004, p. 253) explains that a tax on land values cannot be seen as an additional cost of production as unlike buildings, land is not produced. He notes that because “property owners cannot avoid a tax on land by producing less land (and as they cannot move it from a high-tax jurisdiction to low-tax jurisdiction)” (ibid.) the LVT is simply a cost of ownership.

Therefore, a tax on unimproved land values lowers incentives for speculation or idle holding of land and encourages landowners to put their land into the most productive use (Foldvary 2006). When more land is made available for use, new economic

² The term “unimproved land values” refers to the value of bare land, i.e. exclusive of the value of any man-made structures or ameliorations. The more common “property taxes” fall on both the value of unimproved land and the value of man-made structures (such as residential or commercial buildings). The LVT only falls on the former and as such it does not punish land holders for adding improvements to their land.

³ Stiglitz, together with Arnott (Arnott & Stiglitz, 1979) and Atkinson (Atkinson & Stiglitz, 1987) are known for the formulation of the so-called “Henry George Theorem” which demonstrates and “proves that in a community with optimal population, the land rent equals the value of the community’s public goods” (Foldvary, 2006, p. 2).

⁴ The concept itself has received an exceptionally broad acceptance across the various economic disciplines and schools of thought and its supporters include even such tax-unfriendly economists as Milton Friedman (Löhr & Harrison, 2013, p. 706; Löhr, 2008, p. 126).

⁵ Land is a special and unique type of resource as it is not only “immobile” and “finite”, but it is also “a fundamental and natural factor in any area of business, taking a direct or indirect part in the production of all goods and services” (Raslanas, Zavadskas, & Kaklauskas 2010, p. 61).

opportunities are created, it becomes cheaper to afford a place to live or work, and space is used more efficiently (Löhr & Harrison, 2013, p. 708; Löhr, 2008, p. 128). A more efficient use of land is not only beneficial to economic growth and housing affordability, but also has a potential to substantially lower the costs of public infrastructure and to significantly reduce the burden on the natural environment (Löhr, 2008; Mathis & Zech, 1982; Tideman, 1998; Walters, 2012; Wetzel, 2004).⁶

What is more, the LVT would allow minimizing economically harmful taxes on labour, production and investment making any country willing to implement it a very attractive location for businesses and productive individuals. As it is impossible to hide land, taxing its value is also far easier, more transparent and cheaper than taxing general wealth or income. The LVT hence reduces the need for bureaucracy, lawyers and accountants – both for the government and the private sector (Foldvary 2006 and Wetzel 2004). As summarized by Dan Sullivan (Sullivan, n.d.):

Land value tax reconciles free-market principles with the concept of the earth as a commons. It is the most progressive tax, because it is the only tax that is not passed on to users. It prevents the monopolization of land, stabilizes real estate prices, promotes economic vitality and efficient land use (...). It is easily assessed and based entirely on public information. It also correlates better with benefits received than any other broad-based tax. All government expenditures that are not complete wastes of money increase or maintain land values.

Importantly, from the point of view of political feasibility, LVT seems easier to introduce than other solutions (such as zoning or spatial planning) to inefficient or unsustainable land use. Unlike zoning, its introduction can be gradual and accompanied by concurrent decreases in other types of fiscal burdens, which makes it potentially much more politically acceptable to the wider electorate. What is more, its effects on particular land owners are in line with their land's value and not merely in accordance to arbitrary political decisions. The positive effects of LVT on mitigating urban sprawl and inefficient land could decrease the necessity of having comprehensive spatial planning regulations. At the same time, introducing some spatial regulation aimed at preservation or creation of green or recreational areas (if it's considered undesirable for the public to own them) would not only be feasible due to better and more efficient land use in areas dedicated for residential and commercial use, but also potentially financially beneficial to the whole country. The examples of various public parks suggest that the presence of well-managed, open, green spaces has the potential to significantly increase the values of nearby residential and commercial lands (*Valuing Central Park's Contributions to New York City's Economy*, 2009).

⁶ According to Hiess & Pfefferkorn (2011), urban sprawl may increase infrastructure costs per capita up to 300% compared to a dense settlement. A tax on unimproved land values reduces sprawl and relieves pressures on the natural environment and rural areas by creating incentives for more compact, land-efficient development. With the LVT in place "the greatest economic imperative to develop land will exist where land values are highest, adjacent to existing infrastructure and amenities" (Rybeck, 2004, p. 253). At the same time "areas distant from infrastructure will have low land values and taxes and, thus less economic motivation for development" (ibid.). As "the demand for developed space is limited at any given time, the greater utilization of land adjacent to existing infrastructure will help reduce the demand for development in outlying areas" (ibid.). In consequence, the implementation of the LVT could both encourage more compact urban structures and help to prevent "premature urbanization of the rural areas" (ibid.). Having more compact and densely populated municipalities would likely not only "help to preserve nature and landscapes", but also bring a reduction in the use of roads and energy which in turn would lower pollution, infrastructure spending and transport costs (Raslanas et al. 2010, p. 65).

While most of the revenue from the LVT can be used to finance the government and public investments, a portion of it could be distributed directly, and on a per capita basis, to the citizens in the form of a citizens' dividend (Batt 2012 and Smith & Gihring 2006). The dividend could serve as a transparent and effective replacement of at least some of the elements of the current welfare system and a way for allowing New Zealand's citizens to enjoy some of the benefits of our country's natural resources more in line with their personal preferences. A portion of the dividend could also be used to offset at least some of tax liabilities of those land owners with small parcels and even more modest incomes, who could in any case benefit from the lowering of other taxes. Also, if socially desired, elderly property owners could be allowed to defer and roll up their tax liabilities until they pass away and their property is sold or inherited.

It is worth noting that in the case of New Zealand, the introduction of a simple land value tax would not be an entirely new solution, but rather a return to the fiscal policy launched in the late 19th century when a land value tax was a major source of the government's revenue (Reece, 1993, p. 226). Back then, the land value tax was recognized as "serving goals of equity, efficiency and as having the ability to raise revenue" (ibid.). While economically and socially sound, the national land tax was gradually weakened until it eventually disappeared due to a combination of factors, but primarily because of the pressure of the owners of the most valuable residential and agricultural lands who formed the most influential core of the ruling parties' supporters (Barrett & Veal, 2012; Keall, 2000; Reece, 1993). While those who could lose the most because of a land value tax, remain politically influential, the scale of the problems related to the fiscal privileges enjoyed by the land owners, more and more visibly threatens the well-being of the country as whole. A proposal to introduce a land value tax could therefore not necessarily be politically unfeasible⁷.

The current steep increase in land values across Auckland presents a threat to the country's economic well-being financial stability. At the same time it is merely one of the many symptoms of a broader problem of the fiscal privileges enjoyed by land owners. As this paper has argued, a long lasting solution to the problem of housing affordability, as well as other land-related issues, could be a fiscal reform aimed at capturing and using for the public benefit a greater portion of the unimproved land values. In addition to being a suitable and reliable source of public revenue, a tax on unimproved land values could result in a more efficient land use, mitigated urban sprawl, lower burden on the natural environment, reduced risk of real estate bubbles and a greater housing affordability; and all this without undermining the foundations of economic growth.

⁷ Admittedly, one might question how sustainable a land value tax could be, at least in the current political system. As noted by New Zealand Treasury: "Base broadening by introducing a well-designed land tax (based on the value of unimproved land and with no exemptions based on land use) should be very efficient with little reduction of economic performance. Historically, New Zealand has had a land tax but it had been weakened with exemptions and ultimately repealed, so its sustainability may be questionable" (New Zealand Treasury, 2013, p. 4). While such skepticism may be justified, Robert Keall rightly observes that the dismantling of the land tax in New Zealand took place over the course of many decades, often against the general public's preferences and in the context of a poor understanding of the key principles and advantages of the tax (Keall, 2000). As such a tax could prove beneficial to the vast majority of the electorate, it is plausible that spreading the knowledge about the crucial advantages of the land value tax as a viable alternative to taxes on human effort could "provide the political dynamic essential for the ultimate adoption of a thoroughgoing resource rental system of public revenue" (ibid., p.437)

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