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## The Nation's Balance Sheet

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POLITICAL philosophers have traditionally supposed that the main purpose of the (minimal) State is to protect property, chiefly landed property, and that property rights could not exist in the absence of the State (e.g. Hobbes 1651). It is not surprising therefore that a number of philosophers as far back as the French Physiocrats and the classical English and Scottish economists concluded that the rent of land is a peculiarly suitable source of revenue for financing the primary duties of the State — defence of the realm, administration of the law and maintenance of social order.

It comes as a particular surprise, therefore, to discover that the State makes no effort accurately to ascertain the location, area, or value of the land titles which it is protecting, and is thus denied the opportunity to charge directly for the service which it is rendering. In this it compares poorly with insurance companies, which have an analogous economic role. An insurance company compiles a complete inventory of all the houses and other property that it insures, both as to stock and value.

This anomalous situation is of comparatively recent origin. Historically, the main fiscal burden of the State fell upon landowners. This was true in the Anglo-Saxon period, and also during the feudal period. The privilege of landholding carried with it the duty of serving the ruler in war, or providing a cash payment in lieu of service, and maintaining law and order at the local level. It was only after the feudal period that the cost of financing the primary duties of the State was shifted onto other forms of income.

Economists and philosophers can offer sound arguments, based on considerations of both efficiency and equity, why the fiscal

obligation ought to be returned to the direct beneficiaries of the security offered by the State. However, if the government is to accomplish this, it must have a full inventory of all land at its disposal. This would present few difficulties, for land is easy to identify, value and tax (in contrast to the taxation of personal property which is easy to conceal).

The State does now provide an occasional inventory of property in the UK, in the form of national balance sheets (Bryant 1987). However, these figures are not complete. Both tangible assets (subsoil deposits such as coal, gas and oil, historic monuments, works of art and antiques) and intangible non-financial assets (patents, copyrights and trademarks) are excluded, on the grounds that they would be too difficult to value.

Nor do they provide a break-down of real property between land and what were traditionally known as 'improvements' to land, i.e. buildings and structures. Some use is made of existing data on site values, but no effort is made to value sites separately, even though this is advised in the United Nations recommendations for national balance sheets (Bryant 1987: 109).

Land values are incorporated in the official estimates for buildings plus sites. If these are valued correctly it should be possible to derive land values as a residual by deducting the values for buildings alone, using separate Central Statistical Office (CSO) estimates for the UK capital stock. A weak estimate of UK land value is made by this method in a supplementary note, but it is not included in the official statistics (Bryant 1987: 100; for the results, see Chapters 6 and 8 below).

Valuing land as a residual leads to problems. The capital value figures will be wrong if the life of buildings is wrongly estimated. Also a decision must be made whether to value structures at gross or at replacement cost. The latter is appropriate for commercial buildings, but the former may be more suitable in the residential sector, where older dwellings tend to be worth about as much as new dwellings. Architecture, materials, character, accommodation, and garden size may all be superior in old buildings, which would tend to offset depreciation. Though all buildings need repairs, prudent homeowners in effect make good depreciation as it occurs and thus maintain the value of buildings.

For the public sector, the lack of market valuations for many buildings and works makes it difficult to reach sensible figures for land values. 'Low and sometimes negative' estimates (depending on the year) are obtained for local authority residential buildings, 'from which it would appear that the cost of construction . . . is not reflected in the values which these buildings might fetch on the open market' (Bryant 1987:101). This situation is predictable given that the buildings are erected for subsidised letting to those who cannot afford open market housing, that they are erected in estates which tend to depress the value of individual houses, and that the whole effect of this is registered in individual site values.

However, the valuations were based on valuations made during 1983/4 in connection with sales under council tenants' Right To Buy legislation, adjusted roughly to compensate for the likelihood that the dwellings sold under-represented high rise flats and estates where houses are difficult to let (Bryant 1987:112). Anecdotal evidence of the higher than average capital gains in store for buyers suggests that Right To Buy valuations tend to be under-valuations, perhaps because the effect of the gradual privatisation of estates itself is not taken into account.

As for public buildings and works, there are no market values for these assets because they are not traded at all, and an assortment of ways of calculating their depreciated current replacement costs has to be found. Whereas central government has made some attempt to value its real estate (see Chapter 9), very few local authorities have done so. Local authorities are required to produce figures for flows, not stocks. Thus their investment each year in real assets is known, but the value of their real estate is not. According to Bryant, the official view has been that finding out the latter for each local authority would be expensive and not worthwhile, as it would not lead to policy changes. Central government's only concern is the amount of debt they owe, and in Bryant's opinion there is no correlation between assets held and debt accumulated (Hardie 1987; for a valuation based on debt, see Chapter 9).

In the private sector, market values clearly represent less of a problem. For residential buildings the aggregates are calculated from rateable values up-dated and converted to capital values using the 5% sample survey (20,000 dwellings) of building society mort-

gages conducted by the Department of the Environment (DoE). The value of tenants' rights is ascertained by taking the vacant possession value of dwellings and deducting local Valuation Offices' estimates of landlords' interests. (The same fraction of vacant possession values is assumed to apply in the local authority sector.)

The same methodology is applied to commercial and industrial properties, up-dating and converting rateable values to capital values with the aid of a specially commissioned sample survey undertaken by the Inland Revenue Valuation Office in 1985 (see Chapter 8 and Appendix 1) and the Investment Property Data-bank's price indices. For the break-down of these properties between the sectors of ownership (personal, commercial and industrial companies, banking, other financial institutions, public corporations, and central and local government) current cost accounts are used where possible with rough adjustments to take account of intervals between balance sheet revaluations. However, the correct but laborious approach of sampling company accounts is not undertaken in the commercial and industrial sector. Instead the value of the real estate of these companies is taken as the residual after the value of such assets in all other sectors has been calculated. Though 'reasonable results' are claimed (Bryant 1987: 115), this claim seems optimistic.

Other real estate, belonging to charities, universities, social clubs, sports clubs, etc., is also valued using rateable values and 'limited evidence of modern rental values and rough capital valuations'. Sectorisation of these assets is particularly 'broad brush' (Bryant 1987: 114-116).

Rough estimates are made of the value of local authorities' unused land. House building sites and land with planning permission for residential development are valued using the DoE's estimates of the average value of such land, but data is scanty on land banks held by builders. Sites with permission for commercial development plus construction sites are valued at 2% of the value of buildings (Bryant 1987: 112, 114, 116). This proportion is taken directly from Jack Revell's original work on the national balance sheets in the 1960s and no attempt is made to obtain a more realistic estimate (Hardie 1987).

Omissions of items which contain land value, in addition to minerals and historic monuments mentioned above, suggest themselves: these include vacant and derelict land in the private sector, airwaves, street parking, moorings, foreshore and beaches, reclaimable land such as the Wash, fisheries, sea and estuaries.

### **The National Income Accounts**

An alternative approach to calculating the land value of the nation might be to deduce it from the National Income Accounts. Unfortunately, these offer little scope for evaluating land rent. They give figures for rent, but not figures for rent on land alone, and even the overall rent figures exclude certain elements of rent. For example, while there are estimates of imputed rent for owner-occupied houses, rent is not imputed for any other owner-occupied property. The existing use rents of owner-occupied trading properties are implicitly included in the gross trading incomes of the industries concerned, but the rents of owner-occupied non-residential non-trading properties are not included in the national income at all (CSO 1985: 248).

In the National Income Accounts there is only one entry which relates to transactions in land and existing property. This shows the transaction costs involved when these assets are bought and sold. However, these costs are not closely correlated with the values of the assets.

### **Need for Improved Land Value Statistics**

**Political Duty** The public sector has an enormous portfolio of real assets. For efficient financial management it should review its portfolio. In the absence of a routine assessment, it is not possible to monitor performance in a satisfactory manner. Central and local government are not profit-making bodies but they must pay interest on their debt so they cannot ignore return on investment. They hold assets on behalf of citizens. If asset management is inefficient, citizens who pay taxes suffer by having to carry a higher burden than would otherwise be necessary.

Public corporations have a target rate of return, and the concept

applies to the rest of the public sector; the principle of opportunity cost holds here as elsewhere. Sensible guidelines should be established for new investment. Portfolio review may reveal some assets that are no longer needed, and others that yield little return. Assets that are held by government but are no longer needed tie up funds which could be used to finance new investment. They are also withheld from the private sector, which might make profitable use of them. Assets yielding little in their current use could be redeployed to better uses.

There is one particular asset which is often under-used, or entirely unused, when owned by the public sector — land. Local authorities and public corporations own vast tracts of vacant and derelict land. If the government seeks to manage the economy it certainly ought to start by making the best possible use of its own resources. If it does not set a good example, its exhortations to citizens to be more efficient cannot carry weight.

We often hear that land is a valuable asset, especially as a riposte to suggestions that public sector bodies should sell some of their holdings. But a valuable asset is one that yields a high return. To calculate return it is necessary to know the flow of income from an asset, putting a cash figure to income obtained in kind, such as free office accommodation or training areas for the army. It is also necessary to have a market value for the asset. Yet estimates for income obtained from land are either inadequate or altogether lacking. The government does not even know how much land the public sector owns. Most local authorities do not know the size of their landholdings, and their assets are normally valued at the price at which they were acquired, perhaps many years ago. Therefore, the public sector cannot say whether the yield on its land is high, low or zero.

The government spends £17 billion on debt interest each year. If it could sell off land that it no longer needs and thus cut down its borrowing requirement this would help to reduce the cost of servicing the debt. Citizens ought to have a figure for the imputed rent of government owner-occupied property, for it is an implicit tax which at present they pay without knowing its amount.

**Macroeconomic Policy** Even nominally 'non-interventionist'

governments claim that they have an important role to play in increasing employment, controlling inflation, balancing international trade, reducing cyclical movements in the economy and encouraging faster economic growth. Various policy instruments are used: the public sector's own income and expenditure decisions, the central bank's activities, direct intervention in markets, advice to companies, and exhortation to citizens to change their economic behaviour.

To be effective, macroeconomic decision-making requires accurate and comprehensive statistics. Governments have at their disposal a plethora of data on national income, expenditure and product; government income and expenditure; imports and exports, financial flows, price changes, and so on. Information on stocks as well as flows is needed, and indeed we have figures for the labour force, the national debt, the amount of notes and coins in issue, and the total assets and liabilities of financial institutions. However, though there are figures for rent, but not for rent of land alone, successive governments have been content to be ignorant of the value of the nation's land, the value of the land used by the various sectors, including themselves, and the value of the land not used at all.

Common sense would suggest that unemployed land leads to unemployed people. Yet discussions of 'unemployed resources' never include unemployed land. We hear that the labour market is imperfect, but we never hear about the imperfections of the land market. The conventional macroeconomic view is that unemployed land indicates a lack of demand. If this were true land prices would fall drastically during periods of high unemployment. If there was lower demand for land for building houses, offices, factories and shops, the price of land would drop, the supply of land being the same as before. But land prices do not necessarily fall, which shows that the land market is very different from, say, a commodity market.

The fact that land is also a marketable asset affects prices. The supply of land does not in fact stay the same as before — land-owners can hoard it in the expectation that conditions will improve. Commodities have to be stored, unemployed people have to be supported, and unused machinery has to be maintained, but

land can be kept out of use without imposing any maintenance costs. Vacant land, however squalid or dangerous, can be left alone without prejudicing its value for agriculture or construction. The owner who makes no use of his land is entitled to prevent anyone else from using it, and receives full legal protection for his property rights, even though he pays nothing to the State in return.

Given that land is a necessary input for every human activity, and that the land market is imperfect, a government that is serious about unemployment should take action to bring unused land back into use. The first step would be to ascertain how much unused and under-used land there is in the country, and to whom it belongs.

**Discrete Data for a Discrete Resource** Land is a factor of production but is qualitatively different from capital. Land is the gift of nature; it is not created by human thought and effort. It is restricted in amount; no more can be created. It is a marketable asset which keeps its value and typically appreciates over time. In contrast, 'capital', referring to buildings, vehicles, plant and equipment, is often non-marketable and certainly does not keep its value — it depreciates rapidly or becomes obsolete. But more can be created at any time. Conversely, 'capital', referring to money and financial assets, is not a factor of production — it is a collection of marketable assets. Again, more can be created at any time.

Land and productive capital are part of the nation's wealth; money and financial assets are not, except where they represent a claim on the rest of the world. Financial claims within a country net out. The idea that land is 'really' just a form of capital is therefore wrong: land is unique in being both a factor of production and a highly marketable asset. Investors understand the difference. They speculate in land, as in commodities, financial assets and currencies. They do not speculate in machinery or oil refineries. Land is the only productive asset which is subject to speculation.

As we have seen, the asset role of land can interfere with its role as a factor of production. No owner would deliberately keep a factory out of use. If land was also purely a factor of production every owner of land would keep it in use all of the time, for even a low rent would be better than none. But land is a marketable asset which may actually offer greater long term returns to its owner (though



not to society) if it is kept out of use at the present time. When prices are low, holding sites out of use may help raise prices. When prices are rising rapidly, sites may again be held out of use in expectation of yet higher prices, which will help fulfil those expectations. Thus land tends to be artificially short in supply and its price artificially high.

In Latin American countries land is kept out of use even though landless peasants would be keen to use it. In densely populated Britain most of the Scottish Highlands is deliberately kept out of farming use, and there may be over 1m hectares of land which is derelict and waste (Moss 1981:142). Even in London, where a hectare of land can sell for millions of pounds, there are thousands of hectares of vacant sites. Schemes to restore such land run into the obstacle that the owners will often not sell except at unaffordably high prices (Civic Trust 1988:31).

**Microeconomic Policy** Academics writing about land often put forward arguments which could be true only if the land market was close to perfect. Yet of all asset markets the land market exhibits the most imperfections.

The asset is not homogeneous. Recall the adage about buying property: 'Location is everything'. One house may have a fine view of the sea, the next house no view at all. Thus there are natural monopoly aspects to land. There are man-made restrictions as well. Substantial amounts of land are held by a few owners, who can affect the price. Transaction costs are high, with legal fees, stamp duty, payments to estate agents and auctioneers, and also to the Land Registry. Fraud is easy. The potential buyer's knowledge is often poor: there is no market place, merely a series of deals. Prices fetched are usually kept secret, apart from properties sold at auction. A new owner can conceal his identity.

Insider knowledge is invaluable for making profits from land dealings. Having influence with officials or councillors can also help. The planning system adds greatly to imperfections in the land market, and in some cases has led to bribery and corruption. Rent controls affect the value of both built-up property and farmland.

The land 'market' is important, and advocates of free markets

must aim to improve their operation. Better information is a prerequisite for an efficient land market.

**Fiscal Policy** We began by noting the philosophical tradition that, logically, property owners ought to pay for the minimal State. The introduction of a significant measure of land value taxation would both meet this requirement and tackle directly the conflicts arising from the dual nature of land. Such a policy implies a comprehensive valuation of the nation's natural resources.

### A National Cadastral Survey

'Cadastral' is a word of Latin origin, and cadastral surveys were well known in the Roman Empire. A cadastral survey would be perfectly feasible in the UK. It would show for each plot of land its exact location and dimensions, with correct boundaries, its present and permitted uses, its value as estimated at a particular date as recent as possible, and its current owner. It could build upon the statistics already available in the Land Register. Revaluation would take place at regular intervals.

The law should be reformed so that an entry in the Land Register would be proof of ownership. The Land Registry fee could be higher than it is now, and the profits could be used to finance the survey. (Even now the Land Registry makes a profit.) The National Cadastral Survey would be open to inspection by anyone, and landowners would be entitled to query the values attached to their land. Those accustomed to the cumbersome English system of secret conveyancing and expensive legal fees may be surprised to learn that land registers are common in other parts of the world, such as Australia. Jersey, in the Channel Islands, has always had a land register system, and nineteenth century reformers considered that Jersey's prosperity could be attributed to its small proprietors, whose existence was due to the legal simplicity of purchasing land (Arnold 1880: 302-303).

A national cadastral survey would provide comprehensive figures for the value of the nation's land as a whole and of its regions, and for the value of the land owned by the various sectors of the economy, or devoted to particular uses. The British Government

has not considered undertaking such a survey in modern times. Even the national and sector balance sheets, which are excellent in many respects, do not have an assured future. According to the statistician in charge of these accounts:

Further updates of tangible asset values will be made when resources permit and depending on the contribution it is considered they can make to government assessments of economic developments. From a statistical viewpoint more regular updates would undoubtedly yield benefits in the quality of valuations possible because methods would be continually reviewed and improved (Bryant 1987:101).

Regrettably, there are no current plans to compile complete balance sheets after the 1987 estimates in the 1988 edition of the CSO Blue Book.