How land taxes could pay for urban renewal

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A levy on windfall gains in land and property values would be a good way to tackle transport congestion

Gordon Brown and Ken Livingstone, now locked in combat over the financing of London Transport, could learn something from David Ricardo's 200-year-old analysis of land values. Here is one of the very few examples of a tax that, far from being a distortion, should aid efficiency.

Income generated by work, enterprise or capital investment is diminished or distorted if it is taken away from its owners by tax. On the other hand, there is something called economic rent. This is not the rent that you or I might pay for our home or office, which includes a charge for the use of buildings and other structures. It is the price for the use of pure space. This will be far higher in a thriving urban centre than it would be in a Highland bog. And within urban areas the scarcity value can be much increased by the provision of new public transport facilities or an arts centre.

Ricardo was drawn into the subject because of the argument about the Corn Laws. These were an early form of the European Common Agricultural Policy and were introduced to protect landlords from the competition of cheaper corn from the New World.

Since then, the case for taxing pure space has been widely accepted among economists. In Britain, the most common name for such levies is site value taxation. Another name is "the single tax", under which it was promoted by Henry George, the 19th-century reformer, on the optimistic assumption that it could replace all other taxes.

The UK's Labour government of 1945 was committed to the nationalisation not of land but of land values - or, more precisely, the increments of land values as property prices rose. The measure became hideously complicated to administer. Its opponents found it all too easy to ridicule as another example of Socialist bureaucracy. It began to be eroded even before the postwar Labour government left office.

The cause of land taxation has now been taken up, not by an academic economic or a leftwing politician but by Don Riley, a down-to-earth property developer of New Zealand origin whose sites and buildings in Southwark, south London, are within walking distance of the Financial Times. His study is entitled ***Taken for a Ride***.*

The official view is that it is impossible to distinguish increments in pure land value from the return to the construction and commercial enterprise involved in building on them. Local landlords do not find this task quite so harrowing. Mr Riley's office looks out over a site that was available for purchase in 1980 for £100,000. In January 2000 it was sold for £2.6m. The gain was "money in the bank" for the owners but nothing was contributed to the welfare of the residents of Southwark.

Unfortunately, like other zealots, Riley overstates his case. He even believes that his proposal would allow us to abolish the Bank of England's monetary policy committee and much else. He uses the shrill language characteristic of single-issue campaigners. For instance, government officials, who say that land value increases resulting from public policy decisions cannot be measured, are guilty of a Big Lie. But surely they need not be. A lie is a deliberate untruth. All he can reasonably claim is that these officials are "wrong".

But if we dismiss these embroideries, he has an impressive case. The heart of it is in the big increases in values created by public policy measures, above all the extension of London's Jubilee Line through the south-east of the capital.

His strength is that he adopts a bottom-up rather than top-down approach. It should surely have been possible to tax some of the very large gains that have been created by public policy. And this tax revenue could, as he suggests, be used to finance the capital costs of Tube construction, leaving the passengers to pay for the running costs. He argues that Tube extensions and other urban renewal projects could be made to pay for themselves without either higher fares or the large subventions envisaged in the government's public-private partnership.

The extension of the Jubilee Line cost £3.5bn ($5bn) and, according to Mr Riley, led to an increase in the value of the nearby land of about £13bn. On the basis of a 10 per cent annual return, this is worth about £1.3bn a year to landlords. A tax of 25 per cent on that return would have led to an annual flow to the governmental authority of £325m. This would have repaid the cost of the extension over 20 years while leaving a surplus for other services.

In 1979 California's Supreme Court provided a fig leaf for such taxes by calling them "special benefit assessments". But first it is necessary to have official valuation of land in question and local authorities must be given the power to levy such assessments.

The most attractive feature of the booklet is Mr Riley's frank avowal that as a landlord he would benefit from such assessments rather than by continuing to be a free rider on public policy decisions. The reason he gives is that the revenue generated could be ploughed back into projects that would make the areas in question flourish and thus more than repay his extra tax payments.

According to Mr Riley, urban railways should charge fees to cover only their marginal direct costs and the capital outlays required to finance their construction should come from taxing land in one way or another. The urban transit extension in Hong Kong is being partially financed in such a way.

The author has no neat comprehensive plan. He sometimes talks of land taxes, sometimes of congestion charges and sometimes of the sale of planning permission. Indeed these charges have much more in common than meets the eye. But for any practical reform there would have to be some guidelines about the particular mix of charges - one possibility being to leave it largely to the local authority.

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