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A TOOL FOR ECONOMIC DEVELOPMENT

By Nicolaus Tideman

A land value tax is a periodic tax (monthly or yearly) on those who have title to land, levied in proportion to the value that the land would have if it were not improved. A land value tax reflects the value that is added to land by public improvements such as streets, water service, sewers, parks, etc., but not the value of structures, fences, grading, draining or other improvements to an individual parcel of land.

Land value taxation promotes economic development in at least six different ways. First, land value taxation serves as a regular reminder to those who have title to land that they are not using, that they have something of value that could be put to use. Land is often in the hands of people who have other concerns and prefer not to think about what might be done with their land. A regularly recurring tax bill reminds people that they have something of this and if they have no use for their land themselves, they could save on their taxes by transferring the land to someone else. By putting land in the hands of people who will use it, such transfers of land promote economic development.

Second, land value taxation provides revenue for governments, permitting them to reduce taxes that have harmful effects on economic development. Taxes on wages discourage people from working. Taxes on saving or investments discourage people from saving and investing. Sales taxes and value added taxes discourage productive activity generally. But a tax on land values does not discourage any productive activity. Thus any substitution of a tax on land value for a tax on wages, incomes, savings, sales or value added will increase the efficiency of an economy and promote economic development.

Third, land value taxation reduces the profit from land speculation. Land speculators leave land unused because they think its value will rise rapidly, so it should not be improved now. These expectations of speculators are often disappointed. Valuable land in the centres of cities is often left unused or very poorly used for generations. The inefficient decisions of land speculators to not develop land mean that economies must contend with artificial scarcities of land. When a tax on land value is implemented or increased, the potential profit from land speculation falls. Regular tax bills limit the capacity of speculators to speculate. As a result, less land remains in the hand of speculators and more land goes into the hands of those who wish to use it. With more land in the hands of those who wish to use it, economic development improves.

Fourth, land value taxation provides a special benefit to those who have limited access to capital, and in the process it promotes economic development. Other things being equal, when the tax rate applied to land value is increased, people who might want to buy land will reduce their offers according to the present discounted value of the increase in taxes. But every potential investor will use his own interest rate in determining the amount by which to lower his or her offering price in response to an increase in the rate of a land value tax. Those who have high discount rates will have lower present discounted values for future taxes, and will therefore have smaller reductions in the prices that they will offer for land, compared to those who face low interest rates and therefore have high present discounted values for future taxes. Thus a tax on land value will tend to move land from those who have low discount rates to those who have high discount rates. And those who have high discount rates (those with limited access to capital) tend to get returns on their assets that reflect those discount rates. Thus land value taxation puts land in the hands of those who do more with it, thereby promoting economic development.

Fifth, land value taxation has a particular capacity to finance infrastructure improvements such as road paving, bridges, water lines, and sewers. An infrastructure improvement is worthwhile if its benefits are greater than its costs. Because of the mobility of labour and capital and the fact that benefits of infrastructure tend to be limited to the vicinity of the infrastructure, the benefits of infrastructure tend to be reflected in increases in the rental value of the land in the vicinity of the infrastructure. This means that financing infrastructure by a tax on the land in the vicinity of the infrastructure has three important benefits.

1 When infrastructure is financed by taxes on land there is no dead-weight loss from the taxes as there would be with most other sources of financing.

2 When infrastructure is financed by a tax on land in the vicinity of the infrastructure, assessed so as to reflect the increase in the value of the land that is caused by the infrastructure, no one is harmed by the decision to produce the infrastructure. Everyone is a net beneficiary. Even if the tax cannot be assessed so perfectly that no one is harmed, the effort to assess the costs according to the benefits to owners of land greatly reduces the extent to which net harm to individuals is caused by the taxes that finance infrastructure.

3 By financing infrastructure through taxes on those who will benefit from the infrastructure, land taxes avoid the problem of efforts by beneficiaries to persuade governments to provide infrastructure that is not actually worthwhile. When the beneficiaries are the ones who will pay for infrastructure, they have an incentive to push the government to provide the infrastructure only when it actually is worthwhile.

The sixth way that land value taxation promotes economic development is by generating confidence in governments. Economic development is often financed by foreign investment, and foreign investors ask themselves, before investing, how confident they can be that they will not lose their investments as a result of confiscatory taxes or regulations. Potential domestic investors will also ask themselves whether, considering the risk of confiscatory government action, they would achieve higher expected returns with investments abroad than with domestic investments.

There may be no way that a government can provide an absolute assurance that no future government will confiscate investments, but a government can provide evidence of responsible planning for a future that does not require confiscating investments. By collecting the rent of land and using it for public purposes, a government can provide a signal that it plans to provide for its future revenue needs without having to confiscate the capital that investors bring to the country. Thus in this way too, a tax on land value promotes economic development.

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