

The Case for Land Value Taxation

In a letter to the editor, Nicolaus Tideman, President of the Robert Schalkenbach Foundation and professor of economics at Virginia Polytechnic Institute and State University, argues in favor of the policy of land value taxation. Tideman responds to a recent State Tax Notes (Dec. 27, 1999) interview with property tax specialist Steven M. Sheffrin in which Sheffrin argued that land value taxation is an oversold concept.

In his comments on land value taxation... Steven Sheffrin says that land value taxation is oversold. He mentions three reasons why some economists and reformers favor land value taxation and five reasons why he does not.

The advantages he mentions are: (A) land value taxation does not engender economic distortions; (B) land values naturally rise over time; and (C) land value taxation challenges the political status of powerful landowners.

The reasons Sheffrin sees for not taxing land are: (1) it is difficult to separate the value of land from the value of improvements in built-up urban areas; (2) because property tax rates are typically relatively low, the distortions from taxing improvements may not be that large; (3) for political and social reasons we often want to tax farmland and ecologically sensitive properties at lower rates in order to preserve them; (4) powerful landowners are not really the target of populists these days; and (5) he is not sure how to define "land" when, for example, many trendy parts of San Francisco sit on land reclaimed from the bay.

I would disclaim Sheffrin's reasons B and C for land value taxation, while arguing that he undervalues reason A and has missed other important benefits of land value taxation. Economic distortions generate excess burdens. We are woefully short of empirical studies of the excess burden of taxes on improvements, but an indication that this excess burden is important is the widespread practice of granting tax holidays to corporations that make major investments in communities. This practice places small firms that are responsible for the preponderance of economic activity at an unfair and inefficient disadvantage.

Furthermore, the potential of land value taxation in reducing the excess burden of taxes is not limited to taxes on improvements. We should also inquire into the excess burden of other taxes and consider substituting land value taxation for these.

Land value taxation has rationales beyond those mentioned by Sheffrin. To explain these rationales, one must first distinguish three sources of land value: (a) the provenance of nature; (b) the provision of public services; and (c) private activity on surrounding land. To the

extent that land value is the provenance of nature, there is an argument for land value taxation based on the ethical axiom that the provenance of nature ought to be treated as everyone's heritage and that public collection of the value of exclusive access to land and other components of this provenance is a fair and efficient way of recognizing that all have equal rights to this heritage. To the extent that land value is generated by the provision of public services, land value taxation is a benefits tax. To the extent that land value is generated by private activity on surrounding land, land value taxation is the natural source of revenue for efficient subsidies for such activity.

Sheffrin's reasons for not taxing land are flimsy. While it is true that different procedures are needed to assess the value that land would have if it were unimproved, the question of how accurately this can be done is an empirical question that deserves more attention. With support from the Lincoln Institute of Land Policy, Richard Ashley, Florenz Plassmann, and I undertook an effort to estimate the value of land in downtown Portland, Oregon.... We found that it is true that there are few sales of vacant land in downtown Portland, but this does not make land value taxation unfeasible. Land value taxation is as feasible as the property tax if an examination of the few sales of vacant land shows that it is possible to assess the value that land would have if it were vacant as accurately and cheaply as assessors now assess the total value of property. We developed a methodology that employed the sales of improved as well as vacant land to estimate the value of vacant land. Despite using only the available data on location, square feet of structures, and age of structures, we were able in our preliminary effort to achieve an accuracy of downtown land assessment (as measured by the ratio of assessed value to selling price for vacant land) that was virtually the same as the assessor's accuracy for all downtown property. We expect to finish further work by the end of January. We would expect professional assessors with access to more data to do even better. And the spatial continuity of land values makes land assessment much more economical than the assessment of buildings with their unique characteristics.

The land tax is not oversold. It is badly underused.

As to the significance of property tax rates being low, to compare with the rates of income taxes and sales taxes, one must

compute the present value of property taxes. At a discount rate of 10 percent, a property tax rate of 2.5 percent is equivalent to an excise tax of 25 percent (or slightly less if one allows for the depreciation of improvements). It is true that property taxes on owner-occupied houses tend to offset the distortion caused by the combination of deductibility of mortgage interest and nontaxation of the implicit income of home occupancy. But it would be more efficient to eliminate the deductibility of mortgage interest (or tax the implicit income of home occupancy), reduce the income tax rate, and shift the property tax on improvements to land. Furthermore, the offset of the combination of mortgage interest deductibility and nontaxation of implicit income does not apply to rental housing or to commercial property.

As to reduced taxes for farmland and ecologically sensitive property, there is a potentially plausible rationale for this practice in the possibility that open space increases the value of surrounding land or even provides benefits simply from the knowledge that land is left undeveloped. But these exemptions are suspiciously broad and often aid land speculation.

If these exemptions actually can be justified by the benefits they yield, then they do not, as Sheffrin suggests, undercut land value taxation but rather enhance its efficiency. If they cannot be justified, then we should end them rather than use them as a reason for not taxing land.

As to powerful landowners not being the target of populists these days, I don't know why that should be relevant, or if it ever was.

Finally, there is the question of how to define "land." From an economic perspective, land is what is provided by nature, including locations that are underwater when we encounter them. When land that was originally underwater has been filled so that it can be built upon, as in downtown San Francisco, a proper tax on land would subtract the cost of the filling from the value that land has when vacant and filled. But if, after more than a century, we are unable to estimate this cost, the unfairness and inefficiency is infinitesimal. Furthermore, it is important to recognize that the efficiency of land value taxation, its absence of distorting effects and consequent excess burden, does not depend on land taxes being accurate. Adam Smith noted this. As long as a land tax does not exceed and is expected not to exceed the rent of land, and is independent of how the land is used, it generates no economic distortions and no excess burden.

The land tax is not oversold. It is badly underused.

Ⓞ