

# A FREE MARKET STRATEGY TO REDUCE SPRAWL

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Unused land is far more abundant than we realize. We utilize less than 5% of the total land area in the United States for urban purposes, including housing, commerce, and manufacturing. As you fly across the country all you see is farm, timber, desert and an occasional small community. While less than 5% of our nation's land area is needed for urban purposes, much vacant land within existing cities is bypassed because it is cheaper to build further out than pay the high prices demanded for the more efficient, better located, land. The result is urban sprawl. Why do we choose to utilize land distant from employment, social, and civic needs while bypassing superior land? Why do many of us choose to spend two hours each day commuting to work? Why do our older cities fail to renew or rebuild obsolete buildings? Sprawl is not just about the density of land use. In many cities only one half of the land is devoted to housing and commercial uses while the other half is vacant or under-improved.

Could it be that there are inefficient requirements built into some public policies? Smart growth should not be constrained by archaic patterns that impede or misappropriate free and open urban land usage. Local ordinances and practices within cities that force accelerated suburban sprawl should be abolished. We don't need more regulation, we need greater freedom to act responsibly. Individuals should have the opportunity to decide whether they want to live in the suburbs or in the city. This should not be a coerced decision because of a public policy that impedes growth within the city. Simple tax reform can help to achieve some of the goals and objectives of smart growth without government intervention and wasteful subsidies.

## End the Public Subsidy of Land Speculation and Sprawl

If land holders can produce a higher return on investment by not using land for productive purposes but rather hold it for a higher price from those willing and able to pay the higher price in the future, there is a flaw in public policy. Public policy thereby gives speculative, nonproductive investment a higher return than productive investment. Sprawl is subsidized by taxes on production and distribution and the failure to recapture the benefits resulting from public improvements. If we choose to end this subsidy, we would reduce sprawl.

One example that I know is that of a friend who bought land within the city but did nothing with it. I asked him why he put good money into an investment that had no visible return? He replied that, by holding the land for future sale or development, his long term return, in capital gains would exceed 18% annually. If he built a building on the site now, his long term return would only be 12% annually, including both net income plus capital gains. Why should he use his land now when it would be more profitable for him to not use it, but to hold it for

a larger future gain?

Most major cities have a substantial amount of fully serviced but unused or underused land sites. It is estimated that 38% of the land area in Los Angeles is unused, 30% in New York City and 25% in Washington, D.C. Intercity sites are bypassed because land speculators receive a greater benefit by ignoring the highest and best use of land sites. A greater profit is made when development is delayed and the land price increases to higher levels. But building within existing developed areas uses the existing and underused infrastructure, roads, transit, public facilities, and services. Sprawl requires new expenditures on public goods and services, more government, more taxes, more dislocation. Counterproductive growth limitations and regulations should be abolished. Property taxes should not be levied on new construction or existing improvements, when the revenue needed could be obtained from the land values created and maintained by the community.

The property tax could be shifted to reduce the incentives for sprawl. If the property tax were taken off urban buildings and focused on the land itself, this would penalize land speculation and would reward people who build on their land. Thus land speculation, which promotes a "leap frog" development out of the city and into the surrounding countryside, would decrease. The proposed shift from traditional property tax to a "land value tax" would penalize land speculation and encourage urban redevelopment. Removing the tax on buildings makes them cheaper to construct, renovate and operate, and more affordable to buy or rent. Urban construction creates urban jobs. Capital and labor both benefit.

## A Strategy for Urban Renewal

Established cities could adopt some very practical long-term measures that will make the city a place where people can and will want to live, work, and play in safety. What few city leaders understand is the destructive role that taxation has played in the out-migration of people and business.

What is needed is a continuously self-renewing city and a public policy that can work effectively. Buildings have a limited useful life. Continuous maintenance and frequent retrofitting sometimes extends this life span. Other buildings reach a point where they should be replaced. Some buildings sit vacant for decades even in the city's central business district. Valuable parcels of land are left undeveloped or paved over and used as surface parking lots. The result is a lower tax base and an eyesore.

As urban buildings deteriorate, owners often don't renovate, remodel or make repairs because their property tax may rise. Thus the typical property tax creates suburban sprawl and urban decay. Shifting the property tax

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off buildings and onto land reverses these processes. Taxing land more than buildings usually reduces taxes for homeowners.

One means that has long been available but not brought into general use is to exempt buildings from the real estate tax and begin to impose an annual tax on land sites that makes holding land off the market for speculation a costly proposition. An annual fee on land should be set near what the land site alone would yield if rented by the owner to the highest bidder. Think of how this would change the behavior of land owners. If I owned a parcel of land with a rental value of \$6,000 a year and that was near what the city charged me as my annual fee, my return on investment as a land speculator would be greatly reduced. In order to generate positive cash flow I would either develop the land myself or put it on the market so that someone else would develop it. At the same time, if my tax rate on the building I constructed on the land was zero, my incentive is to construct a building that maximizes my cash flow (i.e., to develop the parcel to its highest and best use in the market). At minimum, land prices would stabilize and the increase in land brought onto the market would be somewhat offset by increased demand. Land prices to builders would tend to begin to fall over time.

This is where the anti-sprawl component appears. As the city begins to renew itself -- as property owners are no longer penalized when they renovate or build new structures -- businesses and people will increasingly see the city as a more desirable place and not just in a few neighborhoods that now benefit by abatement programs and public subsidies.

Exempting property improvements from taxation and collecting all of the property tax from land values (which are created by the community as a whole and not by individuals) is the cornerstone to continuous self-renewal and the reduction of urban sprawl. Community leaders, residents and business owners can discuss how this renewal will take place, to ensure that neighborhoods retain existing amenities and create new ones that will make every neighborhood vital and attractive. By correcting this serious structural flaw in tax policy that has existed for so long, people will gradually return to city, contributing to its self-renewal.

By utilizing land within cities efficiently and in response to the demand for its use, open space and natural habitats outside the city will be conserved. If urban land is used to its highest and best use, farm land and environmentally sensitive land will not be required for inappropriate uses. Builders and developers would not have to bypass serviced but vacant land to construct housing at a further distance from where it is needed or wanted.

### A Strategy for Economic Development

Economic theory recognizes that when government

places taxes on production and on commerce the net result is a reduction in those activities. The reason this occurs is that these taxes add to the cost of production and to the cost of doing business. The ideal public policy would be to reduce taxes on production and commerce and raise public revenue from non-distorting revenue sources.

That non-distorting revenue source is land and natural resources. The central problem which limits the operational success of the economy is the failure to procure the public value which is created by the community. This value ought to be reserved for the community to pay for public improvements. However, this value is to a large extent diverted into private pockets by speculation in land and natural resource values. The correct approach is to create a system in which no-one, except the citizenry as a whole, is rewarded by the collection of publicly created values.

Economists can agree that the economically efficient public finance system is one in which revenue is drawn from the rent that people pay for the use of land and natural resources. These payments do not distort economic activity. Land rent, because it is pure surplus, could be taken and used for any purpose and there would be no negative consequences for the allocation of labor and capital, or in the use of land and natural resources. If this surplus is invested in needed infrastructure and other public services, it will in turn increase land values for future public investment.

### Public Finance by Self-Financing

In the public sector, capital investment in infrastructure projects would no longer be a debt burden, because the projects would become self-financing. User charges for the public services, when combined with the rental income created by these projects, would cover the cost of creating and running a public service.

It was estimated that the BART transportation system in San Francisco produced two times more land value than it cost to build. The public recaptured only a small part of the cost from benefits provided by land taxes and user fees. Most of the cost came from external sources, unrelated sales and income taxes. Most of the profits went into only a few pockets.

Thus, the claim that a community is short of capital is misleading. In fact, a community could become self-sufficient in the supply of capital from internal sources. But a precondition for this is the reduction of taxes on productive capital and labor. Examine, for example, what would happen as a result of the elimination of taxation of buildings. This decision, not to penalize people who invest their savings in new buildings, leads to the stimulation of a higher level of national income, higher saving, and the creation of new capital. According to the study made by Tideman and Plassmann (1998, *The Losses of Nations*, Fred Harrison, editor, Orthila Press), shifting taxes off buildings, production and distribution, and onto land and natural resources, could increase the



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gross national product by 25%, or one trillion 1998 dollars (\$1,000,000,000,000).

The Land Value Tax Shift from labor and capital is not only a key to reversing suburban sprawl and protecting rural environments -- it is a key to realizing the dream and fulfilling promises of a truly free market -- with liberty, prosperity, and justice for all.

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