LAND & LIBERTY
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121 East 30th Street, New York, NY 10016

Congress' New Housing Bills: Government's Latest Gift to Landowners

by Edward J. Dodson

Ask anyone directly involved in real estate development today what the single greatest obstacle to profitable development is and the answer will be the same: THE COST OF LAND.

Land values have skyrocketed during the past few years from Maine to Virginia and in many other parts of the country as well.

For those individuals who already own land or both land and buildings, tremendous unearned gains have been received (admittedly, realized only if they have actually sold their properties). The real impact has been, however, that most families have taken their gain and have had to put it right back into the purchase of another residential dwelling. Chances are that the new home increased as much or more than the one sold, and the family in this situation may have only marginally improved its standard of living.

A generally accepted principle of lending is that a homebuyer's monthly housing obligation, including taxes and insurance, should not exceed 25-28% of total monthly family income; at levels greater than this the likelihood of financial difficulty causing a loan default is an ever-present threat. Based on a very conservative median housing price of, say, $100,000, a buyer would need around $9,000 in cash and an annual family income of almost $50,000 in order to borrow $91,000 at 10% over 30 years. A large segment of our population is thus effectively priced out of the market.

Our government leaders want to subsidize the purchase of homes for low-income groups. Two primary tactics are followed:

(1) make the financing more affordable by subsidizing the rate of interest paid by the borrower; and

(2) subsidize the purchase of land so that housing can be built that will give to the developer a market rate of return but permit the purchase price to be lower than if the building lots had been directly acquired.

In the first instance, the general taxpaying public (including lower-income families) end up absorbing the interest subsidy in the form of higher taxes or higher costs for government services; there is no "free lunch."

In the second instance, we are all putting more money into the landowners' pockets, inasmuch as they receive a market price for the land - the subsidy given to the developer financed by the general taxation of individual wages and other taxes on productively-earned income.

Public policy fails to take into consideration some very clear economic principles: that land is a relatively scarce commodity; its suppy cannot be easily increased as can the supply of automobiles or even housing units (e.g., one can build up just as easily as out). Any special opportunities given to buyers of land in the marketplace beyond a certain level will change the relation between supply and demand; and, if lower interest rates or price subsidies or higher maximum loan amounts are granted to a large enough number of potential house buyers, the demand for land will increase - certainly not the supply - and landowners will ask more for their land and so ultimately they will reap the rewards of the lower interest rates and subsidies, not the poor. What has simply occurred is that the market has capitalized all of the subsidies and giveaways into higher land prices.

There is a solution to this dilemma, one that is deceptively simple. Adam Smith was one of the first to observe that taxes on productive activity (such as housing construction) will tend to add to the cost of the end good or service and thus discourage its production. Taxes levied against static activities (of which landownership is a prime example) tend, conversely, to stimulate production. The reason for this is easy enough to see: if I own a parcel of land worth $100,000 today, and it value is increasing at 10% per year, the land will be worth $110,000 in a year and I will have gained $10,000 without lifting a finger. If this land were taxed at 10% of market value, however, my net gain is zero and I will be induced to either develop the land myself or put it on the market for use by someone who will. The more land thus coming onto the market, the greater will be the pressure toward stabilization of the cost of land for development.

The issues raised by this problem involve more than economics. Is justice not better served by a system of taxation that rewards our citizens for their productive contributions to society, as opposed to the current structure, which perpetuates the transfer of wealth to those who gain by simply holding onto land? Landowning itself produces nothing, yet gives to titleholders an unearned claim on the fruits of the labor of others. To the extent this continues, we not only discourage economic growth but expose our democratic system to a deeply-rooted injustice.

Edward J. Dodson is an executive in Federal Natl. Mtge. Assn. ("Fannie Mae") and is also President of the Henry George School.