

Would the Adoption of Land Value Taxation Drive Down the Price of Land and Increase Housing Affordability?

EDWARD J. DODSON

An important theoretical assertion suggested by Henry George's writings on the subject is whether, as communities approach the full collection of location rental values, the selling price of land will fall toward zero. George predicted this outcome will result because location rental values are no longer privatized and therefore cannot be capitalized into selling price. He concluded that "by compelling those who hold land on speculation to sell or let for what they can get, a tax on land values tends to increase the competition between owners, and thus to reduce the price of land" (George 1879, 416).

The cautious supporter of George's analysis can point to his actual wording and his inference of *tendency*. More generally, George developed his own version of what political economists identified as *the laws of production and distribution of wealth*, which he observed were not absolute in the same way as the laws of the physical universe, but instead of *laws of tendency*. He was well aware of the many variables, or externalities, at play in any society and in local regions.

Even more relevant for the future is the expected change in how people behave in response to the financial incentives resulting from liberation from taxation labor and investment in capital goods—and the simultaneous removal of the financial rewards of hoarding land for speculation. Once the process begins, the dominoes will begin to fall at an accelerated pace in the right direction. As Henry George explained: "[T]his simple device of placing all taxes on the value of land would be in effect putting up the land at auction to whosoever would pay the highest rent to the state. The demand for land fixes its value, and hence, if taxes were placed so as very nearly to consume that value, the man who wished to hold land without using it would have to pay very nearly what it would be worth to any one who wanted to use it" (1879, 437). What full land value taxation accomplishes is eliminating actual or imputed income derived from landownership, which is essentially a static activity. Landownership, by itself, contributes nothing to the community. Low effective rates of annual taxation on location rent allow landowners to hold land vacant, essentially denying these vacant locations to the community for develop-

ment or the creation of employment and commerce, and driving up land prices by artificially reducing the supply of land.

Externalities Abound

Today, externalities affecting land markets are even more numerous than in George's time. In every regional market there are both natural and societally imposed limits on the quantity of land available for development. Our experience with sprawling development surrounding large cities and even relatively small towns shows that these limits are not fixed in any absolute sense. Land that was once outside the ring of reasonable commuting distance is made accessible by limited-access highways or high-speed rail systems. At the same time, land is also set aside for these and other public purposes. As we move away from the high-density development patterns of our older cities and towns, we press our public officials to keep huge tracts of land open for recreation or (more recently) as wildlife habitat preserves. Zoning and other planning tools can result either in more sprawl (e.g., because of large lot zoning) or, as is now more frequently advocated, in the development of walking communities (e.g., because of provisions for mixed-use development or transit-oriented development).

Height restrictions for buildings also play an important role in the efficient use of land, with the added complexity that even in the central cities, higher buildings tend to create more automobile use and land allocated for automobile parking. Parking lots absorb over 10 percent of the land in U.S. cities, but a much higher percentage in our central business districts. As much as 80 to 90 percent of the total is developed as surface parking lots. The amount of land used for automobile parking around the typical suburban shopping center or mall is several times greater than the actual land area developed with stores. A regional mall will include as much as sixty acres of land paved over for automobile parking (Wolf 2004).

These are important characteristics of every regional market, operating in conjunction with other key factors—all of which are then influenced by state, national, and global economic dynamics. If we were to attempt to construct a regional market model for purposes of forecasting land prices, we would need to know a good deal more information, including the following:

- Population movement, most importantly whether immigration exceeds outmigration, and whether those entering have greater or lesser household incomes than those departing.
 - Population demographics showing to what extent the population is aging and how many households are forecasted to have children attending area schools.
 - Landownership statistics to identify who owns the most developable but undeveloped land and whether they reside in the community or are absentee owners.
-

- Scheduled or contemplated infrastructure projects that will take land out of the market and increase (or decrease) the value of contiguous land parcels.
- The effective age and condition of existing housing units, as well as the number vacant because of condition, abandonment, or other reasons.
- The number of new housing units and type constructed annually.

This is only a partial list of the information required to be compiled and analyzed. And, even with all of this detail put into a computer model, other factors may prove to be more powerful than local or regional dynamics. General patterns do exist with some consistency, however. One safe observation we can make is that where economic activity is vigorous, land values are high (and as a result, the supply of decent, affordable housing is heavily dependent on deep public subsidies).

Where We Are Today

A recent study (Davis and Heathcote 2004), funded by the Federal Reserve examined residential land prices across the United States, came to the following conclusions:

- Since 1970, residential land prices have grown faster but also been twice as volatile as existing home prices.
- Averaged from 1970 to 2003, the nominal stock of residential land under one to four unit structures accounted for 38 percent of the market value of the housing stock and was equal to 50 percent of nominal annual GDP.
- The real stock of residential land under one to four unit structures has increased an average of 0.6 percent per year since 1970.
- Residential investment leads the price of residential land by three quarters.
- In the third quarter of 2003 the nominal value of the entire stock of residential land was the same as annual GDP.

Even before these statistics were published, anyone involved in community development understood that land, and therefore housing prices, have been climbing year after year for more than a decade. What is less well appreciated is that land prices have been climbing with periodic "adjustments" almost from the day the colonists set foot on land at Jamestown. For the first century and a half, what made the experience of life in colonial North America so remarkable was the widespread access to enough land to support one's family at little or no cost. Some poverty existed, but the opportunity was widespread for most families to be largely self-sufficient. Today, there are comparatively few families making their living as farm owners. Yet, for the bottom two-thirds of households in the United States, net worth in a home and the land underneath represents most of their personal wealth. Our economic system has failed to provide the opportunity for most people to accumulate sufficient savings from working to take care of expenses once their working lives

have ended. The nation's landed interests have effectively resisted the adoption of full land value taxation as the primary source of revenue for public goods and services, so that most of the revenue comes from the taxation of incomes earned from producing goods or providing services, from commerce, and from property improvements. For those concerned with the development of diverse, prosperous, and stable communities, moving to full land value taxation ought to be adopted as an immediate public policy objective.

As indicated earlier, land value until very recently was approaching 40 percent of the total value¹ of residential property. In many areas of our cities, the percentage remains much higher. The current downturn in the price of newly constructed homes is occurring because there are not enough potential homebuyers with the household income and savings required to afford the financing on the high-priced homes being constructed by developers on land acquired recently at the top of the land market cycle. Of course, prices for newly constructed homes are more volatile than for existing homes, for the simple reason that to a developer a housing unit is inventory that comes with significant holding costs, while for the existing homeowner a house is shelter. Unless a homeowner is pressed by personal circumstances (such as loss of employment, the need to relocate, illness or death, or divorce), the decision to put a property on the market is easily reversed when market conditions are not considered favorable.

There are no reliable statistics on the amount of vacant but developable land parcels in residential communities. Estimates run up to 15 to 30 percent of total land area in many cities and towns. To get a rough idea of the current total residential land value in the United States, we can use the median housing price (see note 1) and the 40 percent land value figure as follows:

- Median residential land value = \$91,000 ($\$227,500 \times 40\%$)
- Total developed residential land value = \$11 trillion (120,834,000 housing units \times \$91,000)

This figure is based on median residential land value. Using average housing and land prices would likely produce a much higher figure. Moreover, none of the vacant but developable residential land is included. We can roughly estimate an aggregate value of somewhere between \$11 trillion and \$14 trillion for residential land across the United States. Land zoned for commercial development in downtowns and edge cities is some multiple of this estimate for residential land.

High land prices (which translate into high leasing costs for office space) drive out existing businesses, particularly those producing goods the prices of which are determined by global competition. The drive to protect targeted profit margins—and share prices—dictates that businesses must reduce the number of people employed in regions where prospective employees demand higher salaries to compensate for high living costs. When greater automation does not generate higher profits, businesses move to regions (or other countries) where overall production costs are reduced. In

many cases today, the land they own is abandoned, the buildings left to decay as a blight on the community. Owners are often successful in having the assessed value of these abandoned properties reduced so that the annual tax bill is so low they are able to ignore the property for decades without any concerns of financial stress. Others simply do not pay the property taxes, and the communities take no action to foreclose (not having the resources to clear the site of derelict buildings or remove toxic chemicals from the ground). Although large cities have gradually cleaned up many of these sites using federal and state subsidies, thousands of smaller communities continue to experience this type of disinvestment and abandonment.

The Future Under a Land Value Taxation Regime

The economic and social stresses associated with spiraling land prices is clear to many but not so clear to others. Numerous analysts discounted predictions of the now evident downturn in the housing sector. Even those who have been forecasting the bursting of “the housing bubble” did not make clear the connections provided more than a century ago in the writings of Henry George. One notable exception is the British economics analyst Fred Harrison. With George’s methodology to guide him (Harrison 2005), he forecasted that the year 2010 would see the collapse of the land market. Harrison’s research identifies a consistent eighteen-year land market cycle going back hundreds of years. For reasons beyond the scope of this chapter, I am inclined to expect the crash to come before then. After this crash, we will have the next decade or so to achieve significant progress toward a land value taxation regime and thereby avoid yet one more recession or depression.

Whether and how far land prices will fall in response to higher and higher taxation of location rental values is more difficult to predict. As a community imposes higher costs on landowners for holding land out of use, we can expect that some owners will put their land on the market or initiate development plans sooner than they otherwise might have. The lower costs imposed on property improvements will work in conjunction with the higher carrying cost on land to stimulate development to bring land to its “highest and best use” as determined by local market conditions. The tendency of land prices to come down—due to the increased competition between landowners for purchasers—may be offset by increased demand. The key variable will be how quickly investors begin to recognize the opportunity to profitably develop locations in the community and the competition to purchase the most advantageously positioned locations. Another variable is the ability and willingness of owners of land parcels to absorb higher annual taxes without feeling any pressure to act. Wealthy individuals or entities may not bring their land to development even at the point where they are paying the full location rental value in taxes. And, of course, a considerable amount of land is owned by government agencies, schools and colleges, religious organizations, and other tax-exempt entities. This could keep the supply of land offered below that sought by investors for development, causing land prices to fall more slowly over time.

Conclusion

Proponents of land value taxation must stress when attempting to convince elected officials and others of the merits of the case that every regional market is affected by distinct qualities. Thus, while it is theoretically possible for the selling price of land to fall to a very low level, this is not likely to occur in the short run. More likely, land prices will stabilize as supply more closely matches demand. This means that government expenditure and private philanthropy will continue to be needed to increase the supply of decent, affordable housing to people whose household incomes continue to fall in real terms. Additional tools, such as the use of “inclusionary zoning” requiring developers to price a certain percentage of the total units constructed to be affordable—and subject to resale restrictions—remain important components to a comprehensive program of community development.

The extent to which communities have already moved toward land value taxation has been too limited to stimulate the type of expansion in economic activity that those accepting Henry George’s analysis of political economy predict will occur when the taxation of location rental values replaces most or all other local taxes. What can be said is this: cities such as Harrisburg, Pennsylvania, which over the last twenty-five years gradually raised more of its revenue by increasing the tax rate on land values, are no longer as hindered by the destructive nature of the traditional form of property taxation. Harrisburg’s revitalization over this period has been ongoing and has reached the point that the city’s revenue base is strong enough to channel funds into its more distressed neighborhoods, where housing needs are great and housing costs surpass the financial capacity of many residents. The city’s turnaround has occurred despite that neither the county nor the school district has adopted a higher rate of taxation on land than on property improvements. The long-time mayor of Harrisburg, Stephen R. Reed, has stated: “The City of Harrisburg continues in the view that a land value taxation system, which places a much higher tax rate on land than on improvements, is an important incentive for the highest and best use of land . . . and continues to be one of the key local policies that has been factored into this initial economic success here” (1994).

There is no other change in public policy with the same potential to stabilize and eventually lower the cost of housing or stimulate the revitalization of our communities in a manner that welcomes a diverse population.

Note

1. “Appreciation in existing single-family home prices cooled to single-digit rates in most metropolitan areas during the second quarter [of 2006], while metro area condo prices were essentially flat in comparison with a year ago, according to the latest survey by National Association of Realtors. The association’s second-quarter metro area single-family home price report, covering changes in 151 metropolitan statistical areas, shows 37 areas with double-digit annual increases and 26 metros experiencing generally minor price declines—many of the areas with declines are showing weakness in the local labor market.

The national median existing single-family home price was \$227,500 in the second quarter, up 3.7 percent from a year earlier when the median price was \$219,400." (Source: "Metro Home Prices Transition in Second Quarter," National Association of Realtors news release, August 15, 2006.)

References

- Davis, Morris A., and Jonathan Heathcote. 2004. "The Price and Quantity of Residential Land in the United States." *Finance and Economics Discussion Series 2004-37*. Board of Governors of the Federal Reserve System, July.
- George, Henry. 1879. *Progress and Poverty*. New York: Robert Schalkenbach Foundation (1975 edition; originally published 1879).
- Harrison, Fred. 2005. *Boom Bust: House Prices, Banking and the Depression of 2010*. London: Shephard-Walwyn Publishers Ltd.
- Wolf, Kathleen L. 2004. "Trees, Parking and Green Law: Legal Tools for Sustainability." *Human Dimensions of the Urban Forest*, Fact Sheet No.15. University of Washington, College of Forest Resources, March. www.cfr.washington.edu/research.envmind/Roadside/Parking_Trees_FS15.pdf. (Accessed 10 January 2008.)