REVIEW Ronald Banks (ed.), *Costing the Earth,* London, Shepheard-Walwyn, 1989, pp. x + 195, £5.95.

Scandal of understated values

By ROGER SANDILANDS

THIS important book exposes the scandalous failure of successive governments in Britain and other countries to provide accurate, up-to-date and comprehensive information on the value of land and natural resources.

Such information as is available is grossly at odds with the data on rental income recorded in the annual National Income Blue Books. Here *net* rental income, including North Sea oil rentals (assumed to equal only the oil tax revenues accruing to government), equal around 9 per cent of GDP. In the USA the proportion officially recorded is even less, and apparently falling.

A team sponsored by the Centre for Incentive Taxation in London has undertaken a meticulous examination of the rather fragmentary official and private-sector data on land and property transactions by type of use, location and value, focusing particularly on 1985, a representative year in that this was not a depression year and yet preceded the 1986-88 property price boom period.

THERE ARE two basic approaches to estimating the capital value of land. One is the spatial method which uses aerial photography and town maps with up-dating based on yearly data on changes in land use to estimate the total area of land in different uses: agricultural, residential, industrial, commercial, public services, vacant land and mineral land.

We learn that the estimated area in urban uses in 1961 was 1.5 million hectares and this increased by 1-2 percent a year to 1.78 million hectares in 1985.

Sample data for representative regions are then used to derive a weighted average of observed selling prices and rents per hectare. Total land value can then be estimated by multiplying these averages by the total area of land in each category.

The second approach is the residual method, used by the Inland Revenue Valuation Office. Here one observes the selling prices of land inclusive of buildings and then deducts the estimated current value of the buildings to arrive at the land value.

The authors show how this methodology greatly understates the value of land because the valuers make far too small an allowance for depreciation. Also, values are based on current rather than potential use value.

Consequently, vacant land is given no value at all. It may be said, however, that if our land policies were changed in a way that encouraged fuller and more efficient land use there would, in a static sense at least, be a fall in the price of land.

In this sense it may be considered illegitimate to value unused land at its potential value. On the other hand, wasteful use of valuable natural resources reduces economic activity and in a more dynamic economy the demand for land and minerals would be greater, thus increasing land values and rents.

On the whole the assumptions underlying the exercise err on the conservative side. In summary, it was estimated that the capital value of Britain's land was £505 billions, or nearly twice the value of the 1985 national income of £260 billions. This figure excludes the capital value of mineral resource rights, and makes no allowance for the way that property rates reduce the price of land.

However, mineral rents (mainly on North Sea oil) and local authority rates revenues are included in the overall estimate of annual rental income. This totalled £58 billions in 1985 or 22% of national income, considerably in excess of the figure given by the national income statisticians.

It could be argued that as well as local authority rates, other taxes have a depressant effect on land values and rents. Taxes on wages, profits and sales may be passed on to the owners of land who are able to extract less rent than may have been possible otherwise.

But the importance of this study is that it shows that even if governments did not rely on this possible dynamic "incidence" effect on rents, a very large fraction of all government expenditure could be financed by a levy on land and mineral rents.

Eminent economists since the time of the French physiocrats and Adam Smith have recognised these rents as the most efficient and natural source of state revenues.

In the light of these new estimates of the potential of land rents for state revenue a radical overhaul of national income accounting is called for. The National Income Blue Book grossly understates rental income for various reasons.

FIRSTLY, the accounts fail to differentiate between rent on land and rent on buildings. Secondly, in the case of owner-occupied property where no explicit rent is paid, imputed rent is assessed only for owner-occupied housing.

Imputed rent on owner-occupied factories, offices, shops and warehouses is all counted as "interest and dividends", despite the fact that around 35% of the value of industrial and commercial property inheres in the land.

Trading profits of companies and public corporations amounted to about 20% of national income in 1985. In that year non-residential land had a value approximately equal to national income. At, say 8% of national income, this leaves 12% as interest and dividends on non-residential capital.

It can thus be seen that such an amendment would go most of the way to reconciling the discrepancy between the figure for economic rent suggested by the national income statisticians' *accountancy* principles and that suggested by the fundamental *economic* principles employed by the authors of this pioneering study. It deserves a very wide readership.

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