

The Role of Taxes in Promoting Development on Derelict Land

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Development on derelict land is desirable because the more intensive use of these previously idle sites in towns and cities reduces the pressure for urban sprawl onto green spaces. This not only protects the countryside environment but also improves the efficiency of the whole economy. Commuter transport facilities (rail, bus and/or roads) do not need to be provided to distant locations. Instead, existing urban transport facilities (especially public transport) can be used more intensively with higher load factors and upgrades in service frequencies, benefiting existing travelers as well as the new ones. Development of derelict land increases the overall intensity of economic activity in cities and towns, thereby increasing the economic potential of all surrounding sites.

Development on derelict land is limited not only by the fact that it is complex, but also by the fact that it is taxed. Development on derelict land results in liabilities for commercial rates, industrial rates and/or council tax for as long as the development lasts, while an owner of derelict land who does nothing with the land pays no tax, despite the harm that derelict land causes for surrounding communities.

Derelict land and buildings are unattractive. They present risks to young trespassers. They are fire hazards. They offer venues for illegal activities such as drug abuse. They harbor gatherings of volatile disaffected youths, whose interests too often turn to graffiti writing, fly-tipping, rubbish dumping, breaking windows, and vandalizing cars. The absentee owners of derelict sites can provide space for offensive advertising without ever needing to face those they offend. For all these reasons, people prefer not to live in the vicinity of derelict land, and therefore derelict land and buildings reduce the sale value and rental value of surrounding property.

Derelict sites represent a failure of reciprocity. Properly developed sites provide a mix of housing opportunities, job opportunities, shopping opportunities and recreational opportunities that contribute to one another in the formation of a community. Derelict sites have value that derives from the potential benefit from interacting with these activities, but they reciprocate with harm instead of contributing to community formation.

To the owner of derelict site, it is an investment that is to be managed so as to yield the maximum possible return. Taxes affect the returns on investments and therefore affect the investment decisions that owners make. It is sensible to use tax policy to motivate the owners of derelict sites to stop harming their neighbors and start contributing to their communities.

There are two taxes that might reasonably be employed to promote more rapid development of derelict land:

- An annual tax on the harm that derelict land and buildings cause to surrounding property values
- An annual tax on land value, to replace existing rates and council taxes

An annual tax on the harm to surrounding property

The most direct way to motivate the owners of derelict property to take appropriate account of the harm that they cause is to require them to pay the costs that they impose on surrounding property owners. This could be accomplished by an annual tax on derelict land and buildings equal to the estimated reduction in the rental value of surrounding property that is caused by derelict state of the taxed site. The principal economic question concerning such a tax is whether the harm caused by derelict land and buildings can be assessed with sufficient accuracy to permit the assessments to serve as the basis for a tax. Research would be needed to settle this question.

An annual tax on land value

While taxing the owners of derelict land for the harm they cause is the most direct way to motivate the owners of derelict land to stop harming their neighbors, there is an indirect way to motivate development of derelict land that could potentially do more to create thriving communities. That is to replace commercial rates, industrial rates and council taxes with an annual tax on land value yielding the same revenue.

Economists usually say that an annual tax on land value is neutral, meaning that it has no effect on how land will be used. The neutrality that is customarily ascribed to an annual land tax comes from the fact that such a tax does not permit taxpayer to reduce their tax liability by being less productive. This makes an annual tax on land value superior to almost all other sources of public revenue, which generally do permit people

to reduce their taxes by being less productive, and thereby cause economic inefficiency. But the neutrality label is inaccurate. An annual tax on land value is actually better than neutral.

One reason that an annual tax on land value is better than neutral is that the revenue that it provides makes it possible to eliminate harmful taxes such as local rates and council taxes. Rates and council taxes as used in the UK today apply to the combined value of land and buildings, but only for land that is in use, and not for unused or derelict sites. Thus rates and council taxes penalize those who contribute to their communities by developing their land, while letting the owners of derelict, community-destroying sites off without any tax at all.

A second reason that an annual tax on land value is better than neutral is that it discourages land speculation. The economists' customary conclusion that a tax on land is neutral comes from a theoretical model in which all participants have perfect foresight, so that there are never any profits from speculation. In fact, people do not have perfect foresight, which leads to the possibility of profitable and unprofitable speculation, in land and in other commodities.

An annual tax on land value tends to reduce the selling price of land, which reduces the profit from land speculation. Also, an annual tax on land value is an explicit cost, so that it tends to have a greater psychological impact than the implicit (opportunity) cost of not receiving the income that could be obtained by using land productively. For these reasons, an annual tax on land value encourages owners of derelict land and buildings to bring them into use or sell them to others who value them for their productive potential rather than their speculative potential. Thus an annual tax on land value contributes to economic efficiency by reducing the amount of land speculation.

An annual tax on land value is generally levied on the value that land would have if it were unimproved. It is assessed on all land, whether or not it is used. For derelict sites that are adversely affected by past pollution, there may be a question of what is meant by 'the value that land would have if it were unimproved'. Is it the value of the land if vacant and polluted, or the value that the land would have if it were vacant and not polluted? The spirit of tax on land value is best preserved if the tax is applied to the value that the land would have if it were vacant and not polluted. Then, in the same way

that an annual tax on land value does not penalize people for improving their land, it would not reward them for worsening the condition of their land. If such a tax causes owners to abandon derelict land, then the abandoned land should be transferred to whoever agrees to clean it up at the lowest price.

Replacing rates and council taxes with an annual tax on the unimproved value of land is not just a theoretical possibility. It is something that a variety of cities around the world—particularly in America, Australia, New Zealand and South Africa—have begun to do. One of the cities that has gone farthest in using an annual tax on land value to replace a general property tax is Harrisburg, the capital of the state of Pennsylvania. Harrisburg now taxes improvements at only one-sixth of the rate that is applied to land. Since 1981 the number of businesses on the Harrisburg tax rolls has risen from 1,908 to 8,864. The value of real estate has grown from \$0.6 billion to \$1.6 billion. The crime rate has dropped by 58%, and the fire rate has dropped by 76%.

Conclusion

An annual tax on the harm that derelict sites cause for their neighbors and an annual tax on land value are two valuable ways to promote the development of derelict land and thereby reduce the pressure on green spaces. Both taxes contribute to economic efficiency for their own reasons. There is no need to choose between them; they can and should be implemented together. Nevertheless, if one wishes to compare them, what can be said is that the annual tax on the harm generated by derelict buildings produces more good per dollar of revenue collected, but the annual tax on land value can potentially raise more revenue and do more total good.