LAND REFORM: LAND USE AND LAND-USE REGULATION

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Abstract

This paper reports on some issues which need to be taken into account in policy towards the introduction of a land tax. The lessons are drawn from papers read at an international conference at Cambridge, Mass. The major issues include the general criteria for efficient and fair taxation; the potential overlap between land use and land tax policy; the economic interrelationship between these; and the public choice aspects of a land tax.

1. Introduction

This paper addresses some of the issues raised at a recent conference on property taxation, held in the United States. The official title of the meeting was the 'International Conference on property taxation and its interaction with land policy'. The conference was organized by the Lincoln Foundation based in Arizona, USA. The Institute has its office in Cambridge, Massachusetts, close to the Harvard University campus. The origin of the funding of the Foundation was a manufacturing fortune build up in Cleveland, Ohio at the turn of the century.

This background information may seem irrelevant to some. In the United States however, it provides firm pointers to the intellectual origins of the Institute, namely the works of Henry George. George was a good example of what has become an endangered species. A successful businessman turned philosopher, he became a populist politician in the tradition of William Jennings Bryan and John Commons, who was one of the fathers of institutional economics. George is best known for his book: 'Progress and Poverty (1880), where he set out his case for the single tax. He argued that a tax on the full economic rental value of unimproved land had both theoretical and practical merit as the sole source of public revenue: it was, in other words, efficient, moral and a sufficient source of tax income to fund public expenditure.

In the theoretical sense this argument had antecedents of the highest order. George could quote both Adam Smith and David Ricardo as sources. In a practical sense he wrote (and agitated) at a time when land was regarded as the only original source of wealth in society and public expenditure was a smaller part of national product. His populism struck a chord in some parts of American society, as can be witnessed by his attempts to mobilize a grass-roots political movement. Again, this is echoed in the campaigns of William Jennings Bryan against the evils of the Gold Standard and in favour of bimetallism, and John Commons' championing of trade unions.

This **political context** of works as influential as that of Henry George provides a framework within which those ideas can be tested. In circumstances where such ideas are put forward as serious instruments of public policy it is vital to be able to recreate this context. This much is evident in contemporary South African circumstances where a land tax has been raised in a number of circles as an option worth pursuing.

It is in this sense that it may be helpful to see what the latter day torch-bearers of Henry George are proposing in the arena of public policy. But it would be helpful only if the modern debate reflected the interplay between theory and practice so characteristic of the original work. The appropriate place to starts such an evaluation would seem to be the logistics of the conference itself.

The conference was attended by some 250 people from 55 countries. This was both the largest and most divergent group the Institute had ever gathered to discuss this topic. The attendants were addressed by speakers such as Robert Solow (the Nobel Laureate, who spoke at a preconference function); William Doebele and Oliver Oldman from Harvard University; various members of the faculty of the Institute; and a wide range of academics and practitioners involved with the subject matter at hand. Most of those who attended, and all the speakers, came from the industrialized countries. The issues raised with respect to land taxes and land use policy were mostly of an urban nature.

This may seem to be infertile ground for a debate on the merits or otherwise of taxing agricultural land. However, there are a number of lessons to be learned from such an interplay between theorists and practitioners. These can be summarized in the following set of propositions.

2. Some propositions

2.1 Whenever taxes of any nature are evaluated, there are certain basic criteria which should be met.

Economists have long debated the merits and demerits of different forms of taxation. There is reasonable consensus that taxes should be transparent, easy to administer, fair or just and non-distorting or neutral. There is unfortunately very little evidence that such an ideal tax actually exists. In modern economies even the single tax would not be neutral with respect to the taxation of different forms of capital, including human capital. A further problem lies with the administrative difficulty of defining and valuing raw or unimproved land. This implies that public policy on land use in both rural and urban areas has to be flexible: there is no 'miracle tax' which will satisfy all the criteria.

2.2 There is a large potential overlap between land use policy and land taxation policy

Whatever the nature of peoples' access to land, ie by individual freehold, communal access or other variations, it is accepted that the state holds three kinds of residual rights over land, namely the right to regulate property use (policy or coercive power), the right to tax property and the right of eminent domain (ie to expropriate with fair compensation). Land use policy deals with the regularity side, and tax policy with the fiscal side. There is therefore a complex interrelationship between tax and land policy: Governments often use tax policy to regulate land use, and regulations to raise revenue. This raises a serious problem, namely that the goals of the tax authorities could, and mostly do, differ from those of the land use regulators. These conflicting objectives mostly lead to confusion and unintended consequences, as is illustrated in the case of the Vermont, USA experience. This case was reported by Dennis Robinson of the Lincoln Institute at the Conference.

The economy of the state of Vermont went through a rapid structural change in the period starting around 1960. The expansion of the Interstate highway system opened an essentially rural economy to the densely populated northeastern United States. The labour force in agriculture diminished from 25 per cent in 1955 to less than 6 per cent by 1986. One of the responses was the Land Use and Development Bill of 1970. This regulated any new development on rural land by requiring a full environmental review of its impact on water and air quality, on highway congestion etc. There was however a minimum level of land size below which such an environmental review was not required. The predictable effect was that this minimum became the ceiling level for land development. Almost as predictable was the reaction of the authorities to what was seen as undesirable speculation. A Land Gains Tax was introduced in 1973 to deter land speculation. This tax was introduced at a very low level for properties which had been owned for a long period of time, but at an increased level the shorter the holding period and the greater the capital gains from a parcel of property. In practice however this tax had little effect on speculation or land development, even at punitive tax rates of up to 80 per cent of capital gains. The economic boom resulting from the opening of the region to tourism etc was strong enough to push land values up fast enough to compensate for the increased tax burden.

2.3 There is much confusion about the economic interrelationship between land taxes and land use policy

Little is known about the effect of land taxes on land use patterns, through either theoretical or empirical studies. Even less is known about the reverse relationship, ie how public choice affects the chances of success of different forms of taxation. In the case of the former there were three empirical papers at the conference which may shed some light on the issue.

Prof Kenneth Lusht of Pennsylvania State University reported on the differential impact of a site value tax versus a tax on land plus improvements, called the net annual value tax. The theory says that a site value tax should a) stimulate development, and b) lower land prices.

These conclusions are however being questioned, specifically as to the short and long run effects. The article reported on the tax-induced effects in the urban metropole of Melbourne, Australia. The empirical results show no significant correlation between a site value tax and new single family development; residential land prices; new industry location; long run land use intensity or alternation/addition activities in the residential property market.

These results are consistent with the 'new view' on site value tax. This recasting of the static theory argues that:

(i) A site value tax may stimulate **quick** development but may or may not lead to intensification in the long run.

(ii) The liquidity and incentive effects of such a tax work in different directions and may even end up in **higher** land prices, especially when the tax is not universally applied.

An empirical study by Prof Wallace Oates of the University of Maryland on the urban land market in Pittsburgh, USA supports the view that long and short run effects should be separated. The point was again made that a site value tax encourages early development as it taxes land in advance of returns. There are examples where such early development is desirable, eg in the case of inner city blight (or also in the case of un- or under-utilized farm land).

The relationship between a site value tax and land use patterns is however also conditioned by other economic variables which affect the cost of holding and transacting in land. This issue was addressed in a paper by Prof Karl Case of Wellesley College in Massachusetts. Prof Case analyzed the relationship between taxes and speculative behaviour in land markets. The general conclusions are that:

(i) the 'mix' of taxes, ie land holding taxes and land transfer taxes, are often more important than the presence or absence of a specific tax;

(ii) land price volatility often overshadows the land tax, which has an insignificant effect on decision making (such as the Vermont case as well as investigations on the land markets in Boston, Taiwan and Japan).

(iii) Land price volatility is more a function of other short term economic variables such as interest and inflation rates etc and long term structural determinants of demand and supply of land.

These analyses are of course a far cry from the effects of the single tax as proposed by Henry George. The site tax is usually levied at a rate far lower than the full tax on land rents. This leads to the fourth and final proportion, namely the political economy aspects of a land tax.

2.4 There is little clarity as to the relationship between land use practices and land taxes

In all the case studies reported during the conference, the politics of land taxes was raised as probably the most important issue. This was manifested in two rather divergent ways. Most of the case studies were on urban land markets in industrial countries, and in all of the cases cited agricultural land was exempted from the land tax or subjected to a reduced tax. Examples can be found in Massachusetts where farms were valued at \$350/ha versus adjacent development land which was valued at \$30 000 per hectare, and in Japan where agricultural land, even within large cities, was exempt from tax. The consensus was that such measures were ineffective in preventing the development of farm land, and direct control was a more effective instrument.

The second issue was the fact that land taxes were a politically sensitive matter in most corners of the globe. The most well known examples include the attempt to introduce a poll tax in Britain and Proposition 13 in California. The major reasons for the politically sensitive nature of land taxes are that they are perceived to be unfair (they are not related to the 'ability to pay' principle) and that they create administrative problems. In short, land taxes affect the distribution of rights and therefore of access to benefits in society. This creates an incentive for interest groups to form coalitions, either as mass movements (the UK example) or to protect specific vested interests (the California example). In both cases these political pressures have an impact on policy implementation, and increase the probability of negative unintended consequences. Taxes and public choice analysis are therefore natural partners in any attempts to analyse the use of land taxes as an instrument of public policy.

3. A conclusion

Whether or not a tax should be levied on agricultural land is an issue which has been raised in the debate on land reform in South Africa. It is hopefully evident from the discussion here that there can be no simple answer to the question, and that the imposition of such a tax would be contrary to much experience worldwide. The only sensible way in which the issue could be addressed would be to take into account

(i) Urban-rural interaction, with respect to the coordination of tax instruments;

(ii) The extent to which the short and long term effects of a land tax are desired;

(iii) The degree to which unintended effects can be controlled;

(iv) The political economy of the redistribution of rights and the expected action of interest groups;

(v) The administrative burden that has to be incurred if such a tax is to be levied.

This is a tall order. One pointer to sound public policy, at least in the immediate future, is the high level of implementation capacity required to set up and maintain effective control over such a tax. It may be more sensible to take the pragmatic route of taxing urban and rural land as a source of revenue for local government while the costs and benefits of a more extensive use of the instrument are more comprehensively measured.