

“Land value return” and building a more equitable economy

By Rick Rybeck January 27, 2022

Introduction

We create infrastructure to facilitate development. But, when infrastructure is well-designed and well-executed, it increases the price of nearby land. This pushes development (particularly affordable development) away from infrastructure to cheaper, but more remote sites. This “infrastructure conundrum” is one cause of urban sprawl that creates many environmental and fiscal problems.

Also, communities seek to improve the quality of life in distressed neighborhoods. Enhancing education, transportation, public safety and other neighborhood characteristics are common approaches. But, if communities succeed with these efforts, rents rise and the intended beneficiaries might be displaced. Public funds spent to improve the lives of poor residents end up enriching landlords who, even in distressed places, tend to be relatively affluent. This “no good deed goes unpunished” problem causes some to conclude that it’s counter-productive to improve conditions in distressed neighborhoods.

This article shows that the economics of sharing can help solve these problems and promote more prosperous, sustainable and equitable communities.

Paying for Infrastructure: Some Techniques Work Better Than Others

Governments pay for public goods and services by levying taxes and fees. “**Fees**” are related to either the benefits we receive or to the costs we impose on the government. “**Taxes**,” however, bear little or no relationship to the benefits received or costs imposed.

For example, sales taxes raise lots of money. Governments could pay for drinking water with a sales tax. But typically, governments charge a per-gallon fee. The more water we consume, the more we pay. There’s some fairness to that. Also, when we pay by the gallon, we tell our children not to leave the faucet running. And when we have a leaky faucet, we see our money going down the drain. This motivates us to fix the leak. If we paid for water with a sales tax, we would not be as motivated to conserve water or fix leaky faucets. Thus, “user fees” can promote both fairness and efficiency.

If user fees are such a good idea, why don't we pay for the entire cost of public goods and services with these fees? If we paid the entire cost out of user fees, the fees might be so expensive that only the very rich could afford them. Many of the benefits of clean water (public health) can only be achieved if everybody can use it. And the massive investments in water purification and distribution wouldn't make sense if it was only being consumed by a few wealthy people.

So how do we make up the difference between affordable user fees and infrastructure costs? Governments often rely on general taxes for this purpose. But, over-reliance on general taxes can allow "invisible beneficiaries" to reap windfall gains, creating the "infrastructure conundrum" and the "no good deed goes unpunished" scenarios mentioned at the beginning of this article. To discover the "invisible beneficiaries" of infrastructure investments, let's return to the drinking water example.

Should owners of vacant lots pay anything to the water authority? They aren't consuming any water (at least not at the vacant lots). Think about two vacant lots on opposite sides of a vibrant big city. Both lots are the same size, the same distance to downtown, have the same zoning and the same demand for development. The only difference is that Lot #1 has water and sewer pipes at the property line. Lot #2 does not have any water or sewer pipes within a half mile. Which lot is more valuable? Many people might think that that Lot #1 is more valuable – and they're correct. Lot #1 is more valuable because it's cheaper to develop. The builder doesn't have to dig a well and create a septic system or extend the pipes (as would be required at Lot #2).

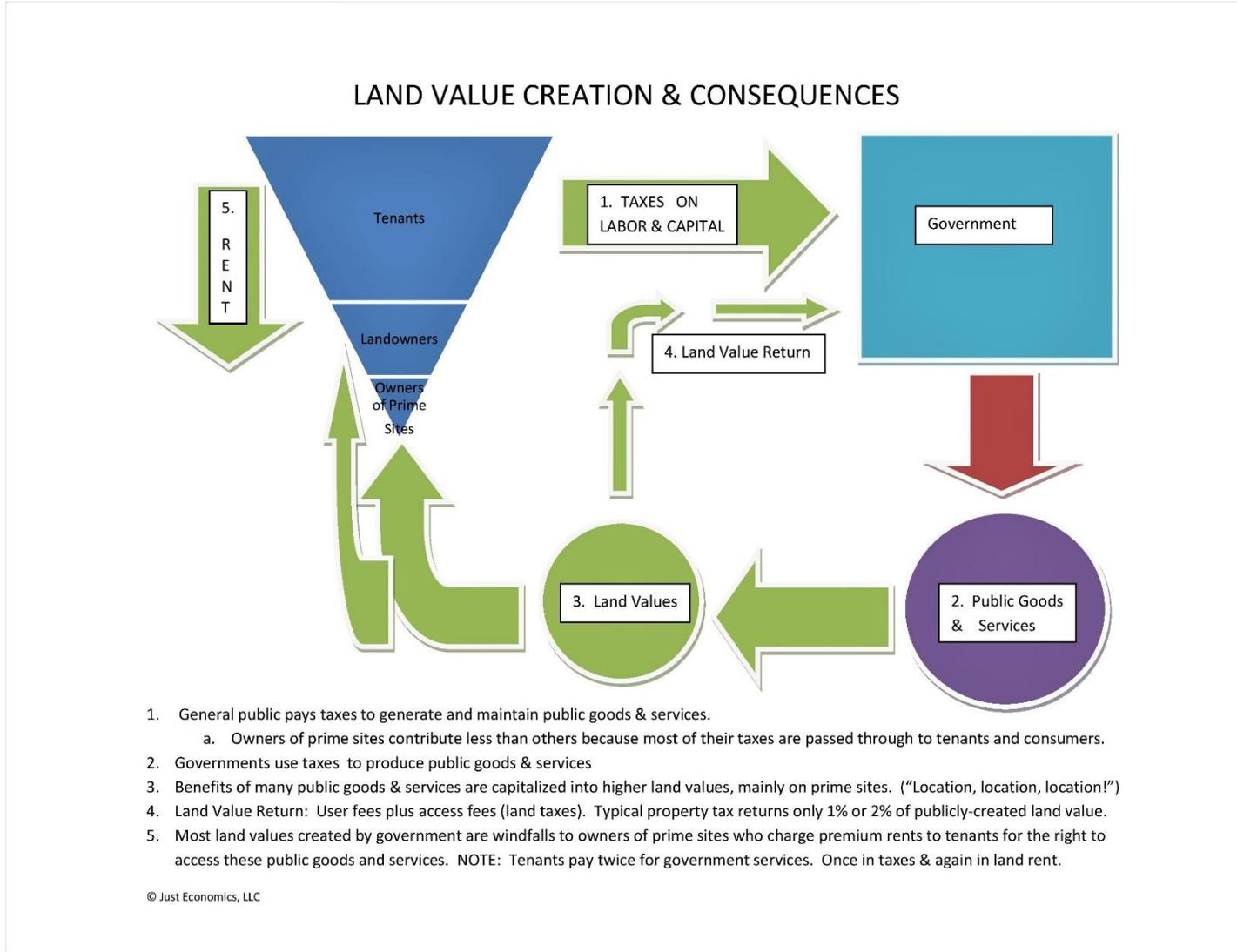
But is Lot #1 more valuable because of anything that the owner has done? No. Lot #1 is more valuable because the water authority has built (and hopefully maintains) pipes up to the property boundary. Thus, the owner of Lot #1 should pay the water authority for value that the water authority creates on that lot. This wouldn't be a user fee. It would be an "access fee."

Private Appropriation of Publicly-Created Land Value

Typically, communities fail to collect adequate access fees. This isn't merely a harmless oversight. **Inadequate access fees result in windfall profits for landowners near new or improved infrastructure. The ability of private landowners to appropriate publicly-created land value is the fuel behind land speculation.** Land speculation is buying land not for the purpose of using it, but for the purpose of holding it until it becomes more valuable. This is a parasitic activity that produces nothing of value while siphoning off value created by the community.

Land speculation tends to create an artificial scarcity of developable land (particularly at prime sites near existing infrastructure) and thereby inflates land prices. Inflated land prices drive residents and businesses away from the most valuable (and productive) land towards cheaper, but more remote (and less productive) sites. The use of sub-prime sites creates sprawl and reduces productivity. This harms the environment, wastes energy, requires costly infrastructure duplication and creates a drag on the economy. Land speculation can also create land price bubbles. When they burst, they drag the entire economy down as happened in 2008 and in every major recession and depression in our country's history.

The following diagram illustrates the money flows associated with infrastructure investments:

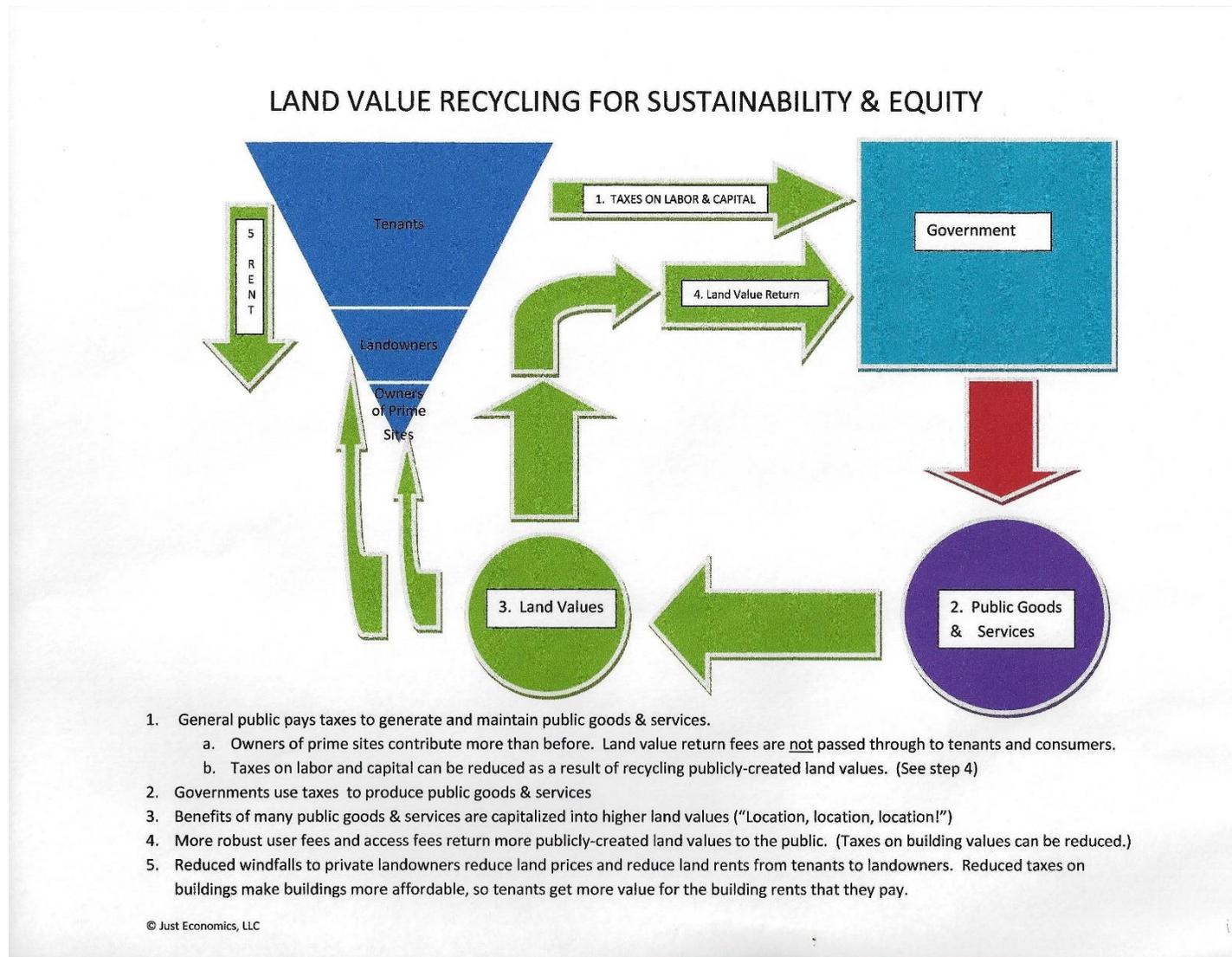


As shown in this diagram, only a small fraction of community-created land value is returned to that community. While property tax rates vary from place to place, in most communities they range between 1% and 2% of fair market value. If this stream of payments were collapsed into a single, one-time payment, it would be worth about \$10 to \$20 for every \$100 of publicly-created land value. Thus, **many communities are giving away 80% to 90% of the land value that they create.** And, not surprisingly, the best-served land in most communities is owned by very wealthy individuals and corporations. So most communities are collecting taxes from everyone and enriching those who are already the most affluent and powerful. This is welfare in reverse or “**wealthfare.**” It is part of the dynamic of growing inequality. It also means that taxpayers who aren’t benefiting as much from infrastructure end up paying for it. This injustice leads to distrust and social division. It expresses itself in taxpayer revolts and growing anti-government feelings.

This diagram also shows that most taxpayers pay for infrastructure twice. First, they pay taxes so that the government can create the infrastructure. But, if they want to take maximum advantage of it, by locating their home or businesses nearby, they have to pay a premium (in rent or purchase price) to occupy that valuable location.

Land Value Return and Recycling

The remedy for this situation is to charge more robust “access fees” to landowners who benefit from public infrastructure. The following diagram illustrates how returning publicly-created land values to the community changes the money flows from infrastructure investments:



Returning community-created land values to a community constitutes the “economics of sharing.” By making land value return more robust, infrastructure investments become financially self-sustaining. (If not completely, then at least to a greater degree than under the

status quo.) This allows communities to reduce taxes on labor and capital, thereby improving the economy and increasing employment.

Land Value Return in Practice

Almost every community practices some form of land value return and recycling. For example, the traditional property tax is a tax applied to the assessed value of buildings and the assessed value of land. That portion of the property tax applied to land values returns these publicly-created values to the public sector where they can be recycled to help make infrastructure financially self-sustaining.

If communities were more vigorous in returning land value to the agencies that created them, the following results could be obtained:

- Land prices would moderate. (Land prices reflect the benefits that people expect to receive from owning it. Returning land values to the community reduces land ownership benefits, thereby reducing what prospective purchasers will pay for land.)
- Because land values reflect the value of public infrastructure, landowners would pay in proportion to the public benefits that they receive. This is comprehensible, justifiable and equitable.
- Infrastructure payments would be highest where land values are highest. This would induce development on high-value sites (to generate income from which to pay the fee). High-value sites tend to be urban infill sites near infrastructure amenities, and this is where we want development to occur. Increasing development near infrastructure within cities and nearby suburbs reduces development pressure in outlying areas. This reduces sprawl. Compact communities require less infrastructure. They are more sustainable both environmentally and fiscally.

Using Land Value Return to Reduce Other Taxes

As mentioned above, most publicly-created land value is a windfall to owners of prime sites. If more publicly-created land value was returned and recycled for public purposes, other taxes could be reduced. Indeed, some communities have pursued this approach by reducing the property tax rate applied to privately-created building values. A tax on the value of a building is a cost of production. Increasing the cost of production reduces the amount of buildings produced and increases the price of those that remain. So reducing the property tax applied to buildings makes them cheaper to build, improve and maintain. As mentioned above, the typical property tax rate applied to buildings is between 1% and 2%. Because this tax is levied every year that a building adds value to a property, it has the economic impact of a 10% to 20% sales tax on the cost of construction labor and materials. This inflates building prices, makes housing less affordable and reduces employment.

Thus, without increasing expenditures or reducing revenues, **shifting the property tax off of privately-created building values and onto publicly-created land values can make both buildings and land more affordable.** This would be good for residents and businesses alike. It

would increase employment. It would remedy the infrastructure conundrum and, by reducing rents, it would minimize adverse economic consequences of improved infrastructure on low-income households.

The economics of sharing, as expressed by land value return, has been used successfully in both rural and urban communities. It contributed to the success of irrigation districts in California and flood control projects in Ohio. Cities utilizing this approach, such as Harrisburg Pennsylvania, have reduced the number of vacant lots and boarded-up buildings while enhancing housing affordability. Although most people don't know about this tax shift, it has been endorsed by the Sierra Club, Friends of the Earth and other environmental and social justice organizations. Herman Daly and John Cobb endorsed it in their book, For the Common Good. (See pages 328 – 329.)

Unfortunately, in most communities, “no good deed goes unpunished.” Infrastructure improvements are often accompanied by adverse, unintended consequences such as higher real estate prices, displacement of low-income households and increased urban sprawl. If properly designed and implemented, more robust land value return combined with lower taxes on building values could fund our infrastructure needs while avoiding these negative consequences.

Employing the economics of sharing more widely would be a good way to show that “ethical economics” is not necessarily an oxymoron. It might even allow people of different political perspectives to find common ground for solving real environmental and economic problems while reducing tax burdens as well.

Would this work in your community? Are you willing to help make it happen?

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