Can we BOTH incentivize private investment AND unlock revenues for smart, sustainable cities?

Lawrence Walters
Romney Institute, Brigham Young University

Smart Sustainable Cities Financing Forum
Ruggell, Liechtenstein
7-8 November 2016

Overview

Sustainable Development Goal #11

Private investment

"Unlocking" through value capture and land taxes

Rethinking land and improvements

Concluding observations

Sustainable Development Goal and targets

SDG 11: Make cities and human settlements inclusive, safe, resilient and sustainable

SDG Targets

- Access to housing and basic services
- Access to transport systems, green and public spaces
- Improved planning, management
- Improved links between urban, peri-urban and rural areas
- Protect cultural and natural heritage
- Reduce adverse environmental impact of cities
- Reduce losses caused by disasters

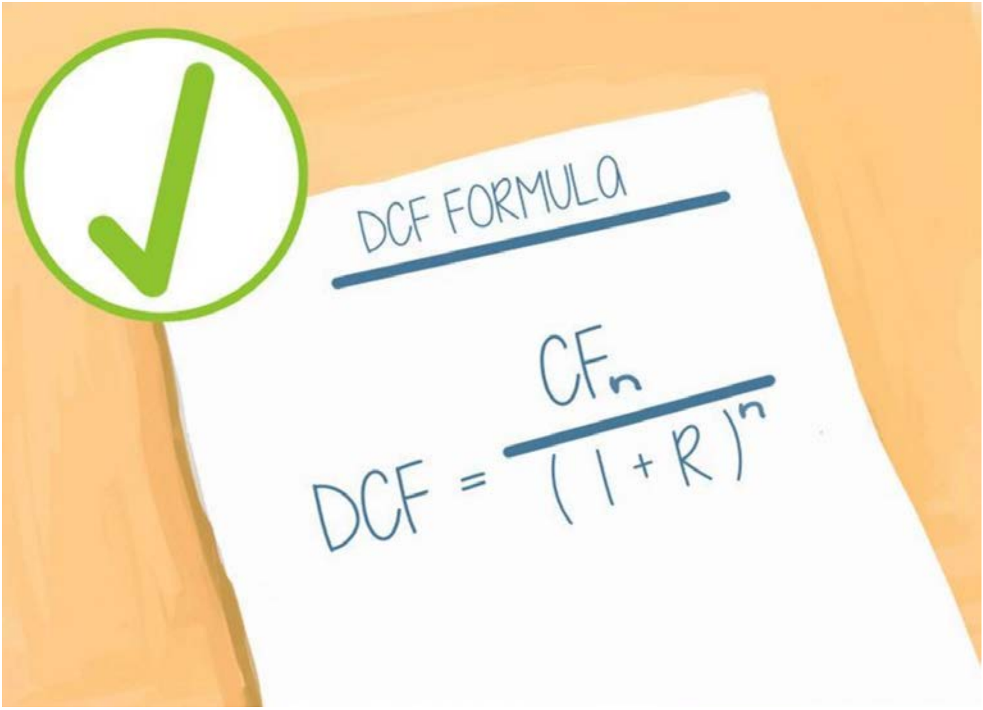
Private investment motivations

Private investment decisions are generally made based on anticipated

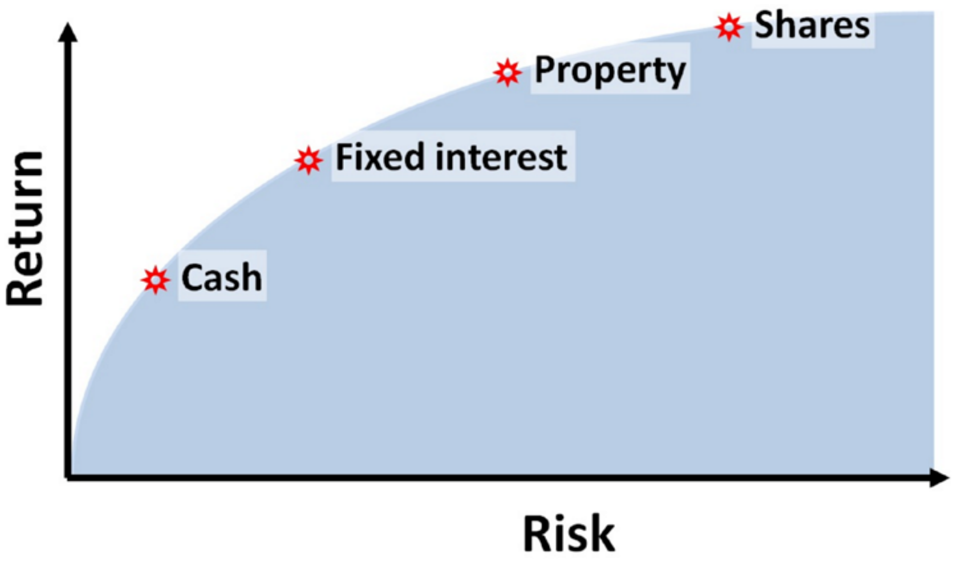
- Cash flow
- Timing of the cash flow
- Risk

Social entrepreneurs?

- Notable because they are exceptional



Private investment incentives



Effective incentives

Improve the cash flow

Improve the timing of the cash flow

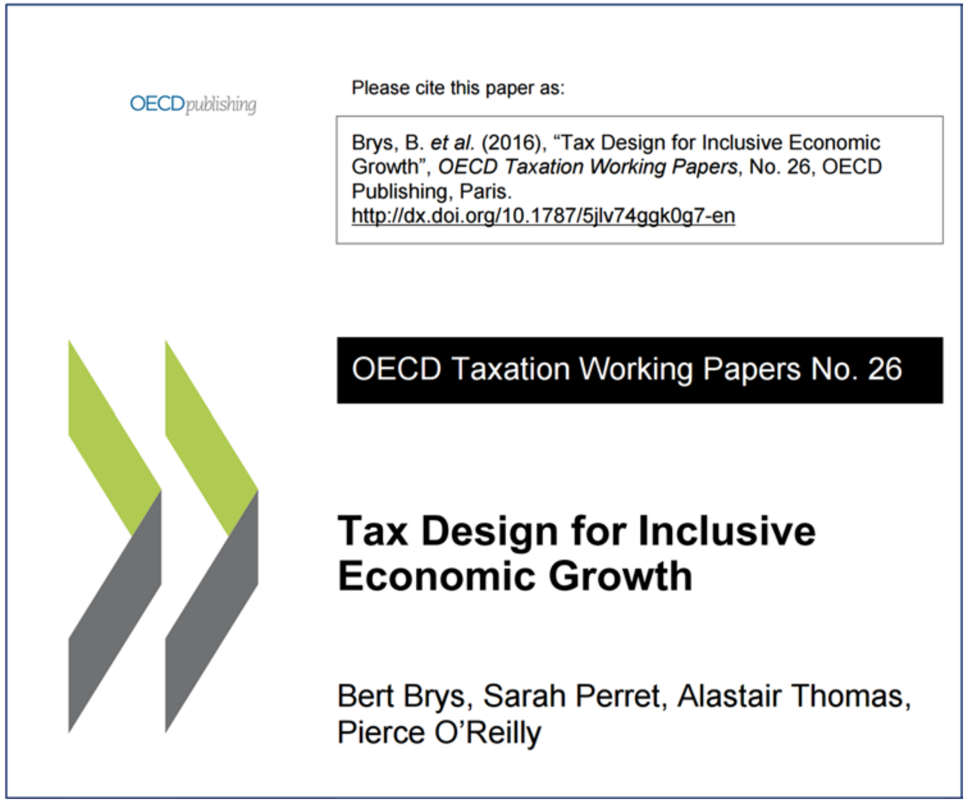
Reduce the risk

Public financing options

"The empirical analysis in the OECD's *Tax and Economic Growth* report found ***recurrent taxes on immovable property*** to be the least damaging tax to long-run economic growth, as compared to consumption taxes, other property taxes, personal income taxes and corporate income taxes."

"These empirical findings are consistent with the ***strong theoretical case*** for certain recurrent immovable property taxes."

"Indeed, ***theory would argue for a pure land tax*** over a property tax as this would not discourage investment in capital improvements."


OECD*publishing*

Please cite this paper as:

Brys, B. *et al.* (2016), "Tax Design for Inclusive Economic Growth", *OECD Taxation Working Papers*, No. 26, OECD Publishing, Paris.
http://dx.doi.org/10.1787/5jlv74ggk0g7-en

OECD Taxation Working Papers No. 26

Tax Design for Inclusive Economic Growth

Bert Brys, Sarah Perret, Alastair Thomas, Pierce O'Reilly

April, 2015

[G]overnments should impose higher taxes on the value of land. In most rich countries, land-value taxes account for a small share of total revenues. Land taxes are efficient. They are difficult to dodge; you cannot stuff land into a bank-vault in Luxembourg. Whereas a high tax on property can discourage investment, **a high tax on land creates an incentive to develop unused sites**. Land-value taxes can also help cater for newcomers. New infrastructure raises the value of nearby land, automatically feeding through into revenues—which **helps to pay for the improvements**.

National Bank of Canada

There is significant evidence to show that the improved connectivity supplied by **new transit services generates increased land and development value**. This is well recognized by the development industry. It therefore seems fair and equitable that **a proportion of this additional wealth, generated by the new transit, should go to funding the transportation facility**.

Scholars who support land taxes

Adam Smith

The Wealth of Nations, 1776

John Stuart Mill

Principles of Political Economy, 1848

Henry George

Progress and Poverty, 1879

William Vickery

The property tax is, economically speaking, a combination of one of the worst taxes—the part that is assessed on real estate improvement … and one of the best taxes—the tax on land or site value.

Milton Friedman

In my opinion the least bad tax is the property tax on the unimproved value of land, the Henry George argument of many, many years ago.

Vancouver Action Plan, 1976

The unearned increment resulting from the rise in land values resulting from change in use of land, from public investment or decision, or due to the general growth of the community must be subject to appropriate recapture by public bodies (the community).

Proposal: A Split-rate Tax

TAX ON LAND

- Land tax
  - Land value capture by community
- Does not penalize development
- Creates an incentive to use the land most productively
- Discourages land hoarding and speculation
- Improves land use outcomes

TAX ON IMMOVABLE IMPROVEMENTS

- Benefit tax
  - Tax equivalent to the cost of providing services to the site
- Positive (or at least non-negative) incentive for additional capital investment

One Example: Taiwan

Two grounding principles in national constitution

- Protection of private property rights lawfully acquired through private investment
- Land value increases resulting from public action or changing social conditions belong to and should benefit all of society

Implementation: 3 separate taxes

- Land value tax
- House tax
- Land value increment tax

Brief description of each

Land value tax

- Annually recurring tax levied on assessed value of land
- Administered by local governments
- Values set annually and rates vary by land use
- Rates are progressive for most properties (0.2% of taxable value to 5.5%)

House tax

- Annual recurring tax based on building value
- Levied on most buildings
- Rates range from 1.2% to 3.6% of taxable value

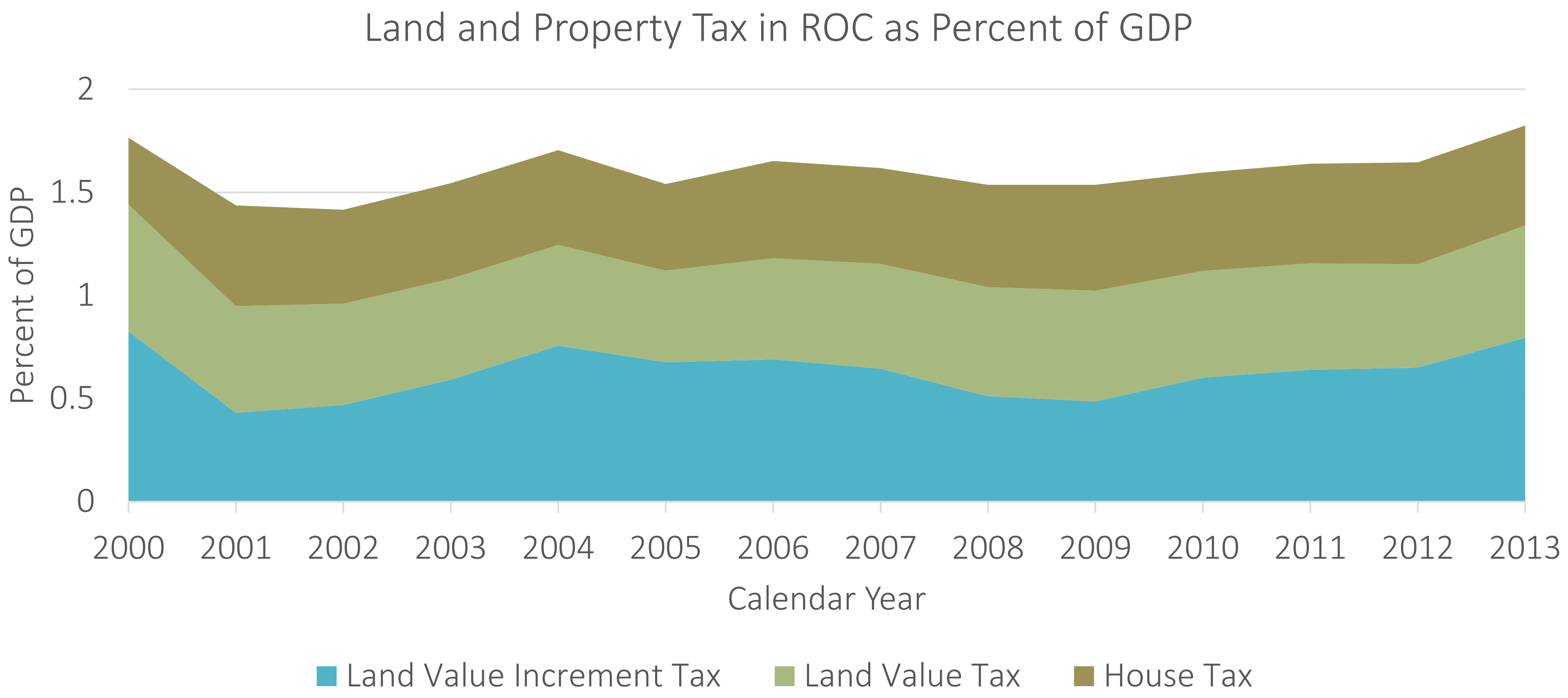
Land value increment tax

- Locally administered
- Collected at time of land transfer
- Base, rate, exemptions, deductions, etc. set at national level
- Base = Current value minus acquisition cost, less deductions for expenses and adjusted for inflation

Allowed deductions

- Investments made to improve land
- Betterment charges
- Land readjustment fees
- Land required to be donated for public purposes

Revenue results



Other options

Developer exactions

- One-time charges at time of approval
- Impact fees
- Required donations of land and/or improvements

Betterment charges

- Charges levied on existing landowners
- Either as one-time charge or collected through special assessments over time

Land readjustment

- Contiguous land parcels combined and reallocated to enhance urban services and development potential

Concluding observations

- Private investment will respond if
  - Cost of doing business is reduced
  - Risk is reduced
- Land and immovable improvements should be viewed and taxed differently
- Incentives to improve land can also unlock resources for local governments
  - Public actions often create private wealth
  - Don’t get too greedy!
- Taxes on immovable improvements should be based on the cost of services

Thank you!

Larry Walters

larrycwalters@gmail.com