

Why Land Value Tax will enable the House-builders to give us plenty of cheaper, better houses

A submission to the Barker Review by Conall Boyle* July 2003

on behalf of A L T E R

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Summary: Today's house-builders produce an inadequate supply of high-priced housing, because that pushes up house prices – just what the customers want. It has not always been thus – the 1930s builders produced good, cheap housing in abundance. This could happen again, but only if the builders are given the right market signals. Tinkering with planning procedures or improving the skills of the workforce will produce only marginal improvements. Only by taking land-values out of the calculation can the house-builders be set free to achieve the productivity gains that are needed to produce good, cheap housing in abundance. Land Value Taxation is the key to solving the housing supply problem.

Introduction:

It would be a huge social benefit if the UK house-builders could produce a plentiful supply of good quality houses; if year-on-year efficiency led to better, cheaper houses as well. Of course none of this happens in the real world of UK house-building . What we have instead is

- a sorry saga of poor quality;
- totally inadequate numbers of houses built – 3 to 10 times more is needed, and worst of all
- unlike other industries, the unit costs of production are rising, leading to yet higher prices.

At first glance, there is nothing structurally wrong with the house-building industry. There is a wide range of firms of varying sizes, fiercely competing with each other. Barriers to entry are minimal. The workforce is a supreme example of flexibility through the widespread use of sub-contracting and job insecurity. In many ways

house-building is a textbook example of Perfect Competition. In theory this should lead to the maximum amount of product at the lowest possible cost. Clearly theory and practice clash in this case.

So what's gone wrong?

In fact, responding to the market signals, house-builders are very efficient. They can adjust rapidly and fully to changed conditions – both up and down. They produce what their customers demand, but this is not cheap housing in abundance. House-buyers seek first and foremost an investment vehicle. Through the machinations of the mortgage market, the need for collateral, the desire for capital gain, what in effect the house-builders do – limit supply, keep costs of production up -- suits the buyers perfectly. Home-owners believe they are making a good investment, but this situation is, of course, disastrous for Society at large. (And despite the investment motive predominating, the reality is that very few homeowners live to enjoy free equity from their purchase, but that is another story)

A permanent affliction?

The UK building industry has not always been so inadequate. During the 1930s England saw a boom in house building -- the ubiquitous pre-war semi. The year 1935 saw the largest number of houses built in the UK for any year before *or since* (more even than during the Macmillan years of massive publicly-subsidised council house building in the 1950s or 60s). A further triumph of 1930s house-building was cost – through efficient Tayloristic methods, the finished price of a 3-bed family semi *dropped* throughout the period, to just under £500 in 1937 -- about £23,000 in today's prices. If only today's house-builders were as good as this, we would have no housing 'problem', no Euro impact, no Barker Review!

Factors which encouraged this 1930s good-quality low-cost housing in abundance included:

- low interest rates
- plentiful supply of land, augmented by newly installed transport systems like buses, the underground and suburban railways

- very limited Planning Control
- rudimentary Building Regulations
- novel design – the semi – originated, not by architects, but by craftsmen-builders
- it was *not* achieved through cheap labour – wages in house-building stayed high during the 1930s

The cultured elite were horrified by these ‘jerry-built’ semis, sprawling out along the newly-built arterial roads, but consoled themselves that they would soon decay or fall down. Soon afterwards, Town and Country Planning Acts prevented much more developments, and the builders introduced self-regulation to control quality – the predecessor of today’s NHBC.

Despite the misgivings, the 1930s semi has stood the test of time. They proved to be well-built and are still here. They are still attractive to buyers, commanding a good price in the market. The preferred solution of the post-war planners – publicly funded system-built architect-designed housing has had a much less happy outcome. Worse, despite all the technological effort, these shabby blocks were *more* expensive to build than the private-sector low-tech semis.

What the 1930s episode shows is that given the right signals in the market the house-building industry can deliver what their customers should want, and what Society needs – an abundance of good-quality, cheap housing. It would be a Friedmanite fantasy to scrap planning laws, abolish building regulations, close down the NHBC – although Thailand offers such an example, and shows that it can produce a plentiful supply of good cheap housing. In the UK nimby-ism will ensure strict planning laws are adhered to, and consumerism will demand quality to be assured by third parties. But it is still possible to create the space for a house-building to prosper and deliver the goods?:

It's all about Land!

Go to any house-builder's headquarters and you will find that the best offices and the flashiest company cars are occupied by the land-buyers. Astute purchases of land are the key to house-building profitability. The land-bank is their main asset. Although house-building is described as a very profitable business in good times, with sale-price mark-ups of 30-50% common, most of this profit comes from increased land values, not construction efficiency. It is by capturing land-value increment that the speculative house-builders prosper. A few percentage points shaved off production costs matters little.

The Land Question:

It is not just house-builders who make unearned profit out of rising land values – all existing homeowners do so as well. This is the ultimate basis for the “rising house prices” headlines. A house is a man-made artefact which can only depreciate from the day it is made. Land is the residual element which creates the homeowner's capital gain.

Using LVT (Land Value Taxation) to tax away the profits of house-builders' land-banks would undoubtedly discourage hoarding and re-direct their attention to the socially much more useful role of producing better, cheaper houses. But existing developed land would also come under an economic stimulus to convert to a more profitable use as well. There is ample developed land throughout the UK even in the areas of highest population pressure. Much of it is occupied by fag-end housing – Good though the 1930s semis were in their time, replacement, not refurbishment is now called for. In addition, many houses are seriously under-occupied with elderly family survivors barely coping with repairs and maintenance. Owners are hanging on to these old houses on large plots for various reasons, not least because rising house (land) prices offer a kind of security and perhaps a bequest to hand on.

It might seem cruel and politically inadvisable to try to winkle such people out of their homes via a land value tax. There are ways to soften the blow, which are

described by Muellbar in his Treasury Euro submission. But think of the benign consequences of LVT

- LVT would be a prodigious money-spinner. Its proceeds could be used to lift all the other property taxes which distort the market – Council Tax, Stamp Duty and Inheritance Tax (again see Muellbar for a description of why these taxes are so damaging *to the efficient working of the housing market*)
- the market pressure of LVT will encourage a plentiful supply of re-developable plots. One-off building on existing streets is far less disruptive than large green-field sites. Allowing some intensification of use would not be too controversial. House-builders would quickly learn the skills needed for neat, quick one-off building.
- Lots more housing appropriate to today's smaller household sizes could be produced – more McCarthy & Stone sheltered accommodation, less 3-bedroomed family semis.
- Knowing that future windfall land value gains would be taxed away will concentrate the minds of *customers* to look more for product values and less for investment vehicles. Industries need fussy customers who demand that producers deliver quality at a reasonable price – just what the house-builders need to prosper.
- This last pressure may encourage house-builders firms to amalgamate in order to pursue efficiencies of scale. There is no shortage of ideas among today's house-builders firms – just insufficient scope to implement them.
- Investment in housing should rise, total number of units built should increase many-fold. At present home-buyers 'invest' over £35 bn in mortgage interest payments. The cost of newly-built houses is one-tenth of that amount. If just a quarter of mortgage interest payments were diverted into real housing investment ie new building, this would *triple* the number of new houses.

Conclusion:

Palliatives like 'more training of skilled craftsmen' or 'speed up the planning process' will do very little to address the central problem: the inability of today's house-building industry to produce many more good quality homes at

lower cost. Only by getting a grip on land values and turning them to the benefit of home-owners, can house-builders be given the right signals through the market mechanism of achieving the goal of a plentiful supply of good-quality housing efficiently and cheaply produced.

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*Conall Boyle recently retired after many years teaching Economics at UCE Birmingham to students of Building and Surveying. It is from my students that I learned so much about the way that the House-building industry really works. I have also produced papers which form the basis of some of the claims made here:

- The Housebuilding Boom in England in the 1930s in *Proc Euro. Network of Housing Research* Birmingham 1992
- Housing and the Finance Markets in *Proc RICS Conference* Glasgow June 2002

I also draw on the many publications of Prof Michael Ball, formerly of South Bank University as well as Prof Muellbar, Oxford.