Transforming the Nation's Finances:
the Plan for Implementation

Ronald Banks[1]

Britain's security would be jeopardised if she quit the European Union, according to Prime Minister David Cameron and those who have a financial stake in the emerging Euro super-state. But the greatest threat to the UK's security and financial viability stems from home-grown policies, which are also applied by the EU. The challenge is to dismantle the barriers to prosperity. Ronald Banks explains the steps needed to entrench a strategy for strengthening society and the economy.

THE British government is retrenching on front-line services, on which people depend for both civil and national security. Budgets for the military, the police, and investments in strategically vital infrastructure are all under threat from a fiscal doctrine aimed at cutting spending without boosting the productive potential of the economy. This precarious situation would persist, whether the people of Britain choose to remain inside the European Union, or whether they vote in the referendum to go-it-alone.

The UK's Achilles heel is a flawed system of governance. But where should the remedial action begin? I argued in the first two articles in this series that the government's revenue system is not fit for purpose. Taxes on productive effort deter people from generating the incomes that they need to support their families, and create the resources that can be invested in "public goods".

Dismantling the bad taxes must proceed in tandem with reforms to the way government charges people for the use of public services. Existing taxes deter improvements to land, because they impose a levy on buildings. And they provide politicians with tools for currying favour with the electorate, by freezing the rates of taxation. The crisis that afflicts the public's finances is Euro-wide. An example from Germany is provided in Box 1: the procedures expose incoherence in the approach to administering the financial affairs of state that would not be tolerated in a private enterprise.

The cost-effective way to remedy the failure of fiscal governance is to remove improvements from the tax base, and phase in new, simple charges on the imputed rents of land and natural resources. Opponents of this reform claim that, in terms of urban land, there are difficulties in separating the rental value of land from the profits that accrue to the capital improvements on the land. There is no basis to this objection. Denmark has operated a sophisticated system of site valuation for the best part of a century. Originally, the valuations were performed by local groups of people chaired by professionals: they knew, street by street, exactly how values moved. Now, computers are

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employed for mass appraisal purposes. The valuation system is not perfect. Even so, the appeals against land valuations are far fewer than for the assessment of total property values.[2]

Box 1:
Property Taxation in Germany

Europe-wide, the property tax is a mess. It raises a very small part of government revenue, but inflicts a disproportionately large wound on the productive potential of the people. An example from German illustrates the bizarre, convoluted lengths to which governments will go to avoid rational reforms to the productive potential of its territory.

The case illustrated here is of a residential dwelling located in southern Germany and owned by Dr. Dirk Löhr, a tax advisor and Professor of taxation and ecological economics at the University of Applied Sciences, Trier. Its market value (2015) is €265,000.

- The assessed value, for tax purposes, is its 1964 value: €20,605. In general, the average taxable value (*Einheitswert*) in Germany is some 10% of the market value. To this value, two multipliers are applied:

1. The first multiplier (*Steuermeßzahl*) depends on the type of house. For a detached, single-family dwelling it is 2.6 per mille (2.6/1,000). For a 2-family dwelling, 3.1 per mille, for agricultural business properties it is 6.0 per mille, and so on. In Dr. Löhr's case, the multiplier is 2.6 per mille. The taxable value is multiplied with the *Steuermeßzahl*. The result is the "*Steuermeßzahl* value": 20.605 x (2.6 / 1,000) = 53.537.
2. The *Steuermeßbetrag* value is then multiplied by a rate set by the municipality (*Hebesatz*). This *Hebesatz* differs markedly from one municipality to another, and can range from some 200%, to about 700%, depending on the economic status of the municipality.

- In the case of Dr. Lohr's property, the *Hebesatz* is 300%. So the sum works out like this: 53.537 (*Steuermeßbetrag*) x 3.00 (*Hebesatz*) = €160.71 (the property tax liability).

When related to the market value of the dwelling (€265,000), Dr. Lohr's annual tax burden is 0.06 %. Most of that liability falls on the value of the building.

Phasing in Fiscal Reform

Realigning fiscal policy needs an electoral mandate. This would flow when people become aware of the benefits of reform. The process of transforming the public's finances cannot be achieved overnight, and it would require the willing cooperation of the public to facilitate the phased transition to a new kind of High Finance.

- ✓ It would take three to five years to enable Parliament to complete the legislative process and to assess the unimproved value of land.

[2] Anders Müller and Gregers Mørch-Lassen (1989), "Land Valuation and Fiscal Policy in Denmark", in Ronald Banks (editor), *Costing the Earth*, London: Shepheard-Walwyn.

Britain's professional valuers are equipped to provide an accurate assessment of what a plot of land was worth without the buildings on it, but surrounded by all the existing developments. They take into account current use of the location, existing planning controls and economic potential. Initially, to get the new system working, it would be sufficient to record approximate values. This is what happened when, after the Poll Tax fiasco of the Thatcher era, the Council Tax was introduced. In Bristol, one firm of valuers quoted £3.50 to assess each property in their area. It lost out to a quote of £1.50 per property. The council was willing to accept a cursory assessment of properties. Nonetheless, the procedure was considered sufficiently robust for the new tax to be implemented.

- Reassessment of values should be no more than 5 years, but 3 years in a fast moving town or area where land values change very quickly.

The public deserves a fair distribution of the rents in locally and nationally owned government property. Hopefully, the old system of long leases and gifts to property lessees of no or long rent reviews has gone. But mistakes are still made. My research in 1992 showed that there was recognition of the mistakes by the relevant officials, but politicians still held sway and they made political decisions based on unemployment figures, prestige projects, etc.

Ideally, land valuations would be carried out every three years, because of what I call the "moving target".

- Conventional taxes depress land values. Reducing taxes has the opposite effect: raising the rental value of land. The appraisal system needs to take this into account when preparing to construct a fit-for-purpose system of public finance.

Rising rental values provide an ever increasing base for public revenue as taxes continue to be reduced. This is the virtuous circle that arises from eliminating the deadweight loss taxes in favour of greater clarity in the pricing system as it operates both in the private and public sectors.

Overcoming Political Opposition

Civil society would have to remain alert to ensure the integrity of the reform process. The lesson of 1909 reminds us that a democratic mandate may not be sufficient to secure wise reforms. Back then, the Liberal government's fiscal reforms were successfully promulgated, as the first step to a full land rentals charge. The reform process was thwarted by landowners: they used the courts to defeat the vital process of valuing the land. Such tactics are likely to be used again, but the present dire financial situation might encourage MPs to drive the reform through.

One step that an enlightened government should take: by-pass HM Treasury and ask the National Audit Office to estimate the 'deadweight losses' that are foisted onto people by the existing tax regime. Publication of the enormous losses would concentrate the minds of MPs and help them to take control of the nation's finances.

Another lesson that needs to be learnt from the past: avoid fiscal gimmicks driven by ideology. There is no improvement to the wealth of the nation by resorting to instruments like Land Development Charges. This tool was introduced by the Labour Government in 1947. Such charges leave untaxed vacant land sites and empty buildings in their wake as eyesores.

The Planning System

The proposal to shift the public's finances onto the market-based rents of land does not mean we have to abandon the planning system. When assessing rents, property valuers take into account existing constraints on the use of each site.

Planning controls are normally restrictions on development, authorising development on a plot of land according to its zoning as residential, agricultural, industrial, commercial, office or retail shopping. When permission is granted to change a property or site from current use to a more profitable one, this is normally associated with uplift in land value. That value accrues to the private owner. Farm land on the edge of towns is a prime example, where low value rural land becomes enormously valuable when it can be used for commercial purposes.

Planning permission, like investment in public infrastructure, illuminates the way in which – under existing fiscal procedures – there is a great and wilful loss of income to the public sector.

- ✓ When the reputation of a school is upgraded, because of increased funding in the employment of good teachers, surrounding house values respond – *upwards*.
- ✓ When a by-pass is added, reducing the congestion and pollution to village high streets, residential and commercial prices are *raised*.
- ✓ When the Jubilee underground line was extended to Canary Wharf in London, property owners along the south bank of the Thames enjoyed windfall gains which totalled *£13 billion*.

Under current methods for taxing property, those community-created values are allowed to sluice into private pockets. To achieve both fiscal fairness and economic efficiency, they should be monitored and collected by the community to defray the costs of funding public services. Unfortunately, public agencies have not been as efficient as the City of London in making sure that it collects what it creates.

The City of London

Back in the 1990s I surveyed the way in which towns and cities administered their real estate. I found that many cities released land by way of a long ground lease, sometimes for a single premium and sometimes on the basis of a percentage of the “Rack Rent", with five-yearly rent reviews. In general, the administration of public land short-changed the local population. Some of the procedures have been revised, but the public gets nowhere near what it is entitled to as revenue.

Metropolitan London covers about 462,000 acres. A very small part of the capital is the City of London, which covers just over one square mile. It is one of the most valuable square miles of land in the world. The City is a local authority in its own right called the Corporation of London.

The Corporation has extensive land and property interests. Property taxes generate substantial revenue, much of which is passed to the Government for distribution among other local authorities. The Corporation owns about 25% of the City’s land and buildings (30% with roads). Only recently has the Corporation begun to reveal some of its financial secrets (Box 2).

Box 2
Secrets of the Square Mile

In 2012 the Corporation published, for the first time in its 950-year history, details of its ‘City’s Cash’ fund. An 8-page City’s Cash Overview document revealed that City’s Cash, which is a combination of funds and endowments built up over centuries, had grown by £70m over the previous 12 months to £1.32bn. The fund is dominated by the Corporation’s property holdings valued at close to £900m. The rest is made up of stocks, equities and bonds.*

* https://www.thebureauinvestigates.com/2012/12/20/city-of-london-corporation-reveals-its-secret-1-3bn-bank-account/

After the experience of the 1980s property boom, there is now a harder-headed approach, and rent reviews take place more frequently. In the case of the City of London, because it is one of the most prestigious and valuable areas in Great Britain, and it is a reliable landlord that deals honestly and competently with tenants, it is able to negotiate favourable terms when contributing land to a development and receiving a percentage of the “Rack Rent". Whereas Bath, for example, looked for 10%, the Corporation looks for upwards of 20% of the “Rack Rent”. This reflects the City’s land/building ratio, but still does not address the problem of increasing land values and depreciating buildings.

In general, the people of Britain have been ill-served by their local and central governments. For historical reasons, High Finance has operated against the welfare of the nation. The financial deficit exists because of the democratic deficit. That deficit will not be closed until we have the results of a full audit of the rental potential of all land, and full disclosure of that information to the public. Only then can people make informed judgements on the stewardship record of their elected representatives, and insist on the restructuring of their public finances.