

Incentive Taxation

LVT Towns Grow Faster Than Other Towns in South Africa

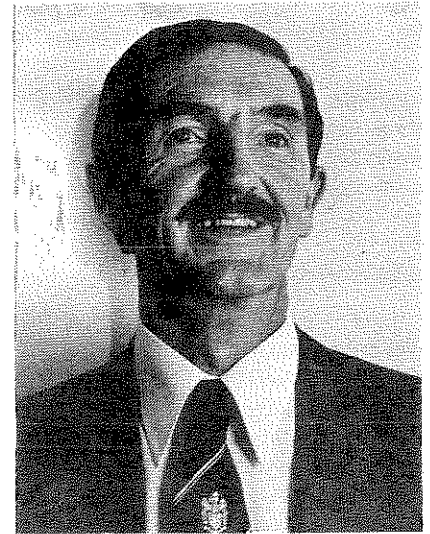
When most people think of the Republic of South Africa, it is its intractable race problems which come first to mind. Naturally - it is a ticking time bomb. But if we could look past that problem for a moment, we could obtain a useful lesson on how that nation promotes economic growth in its cities at no cost whatsoever to the government. We could do likewise.

An excellent study shedding light on this matter has just been completed by Godfrey R.A. Dunkley, a mechanical engineer specializing in the design and sale of fluid filtration equipment. He is the immediate past president of a leading professional mechanical and electrical engineering institute. His avocation is economics and his study (copy for \$5 upon request) is based on information in the official R.S.A. Municipal Yearbooks, which in turn cite official government statistics.

By American standards, the tax rate on land in those cities which use only LVT (land value taxation) is quite high. For example, in Johannesburg the tax rate is about 2% on residential sites and about 4% on commercial and industrial sites. The average range of the 35 LVT-only cities and towns in South Africa is from 1 to 7% as of 1979. Keep in mind that these rates are applied to full assessment values (100%) although to be sure some inflation in property values between triennial re-assessments does occur.

Local government expenses are lower in the R.S.A. than in the U.S. because education, police and certain other services are not financed locally, but when local taxes are levied on land only, the rates are then significantly

Godfrey
Dunkley



cantly higher than in America.

In addition, Johannesburg like many other South African towns levies a 33 1/3% betterment land tax: if a zoning change allows a more intensive use of the land (e.g., from agricultural to residential), then one-third of the land value increase is taxed away. Moreover, the developer must foot the bill for infrastructure costs such as roads and utilities which then goes into the selling price of the land.

It should also be kept in mind that the national government levies a substantial tax on mineral production, such as gold and diamonds, based on a mineral grade formula.

The Findings

Dunkley's study discloses two important facts:

(1) In the R.S.A. there has been a steady shift away from a flat property tax rate (same rate on land and buildings) to two rates (a tax rate on land anywhere from two to five times the rate on buildings), and from both of those rates to a tax rate on land assessments only (LVT). See Table I below. By 1979 fully 60% of the taxable land value in the R.S.A. was in the LVT-only towns. One can therefore assume that LVT has been succeeding both economically and politically.

(2) The study showed that the more a town taxed land values, the more likely it was to show greater construction growth. To substantiate this, Dunkley first gathered statistics on the 125 largest towns (out of

Honor Roll

These five cities and one county are on the IT Honor Roll. The following are the ratios of their land tax rates to their building tax rates:

| | |
|---------------|-------|
| Pittsburgh | 5.6:1 |
| McKeesport | 4.5:1 |
| Scranton | 3.8:1 |
| Harrisburg | 2.7:1 |
| New Castle | 1.8:1 |
| Hawaii County | 1.2:1 |

—To these American localities should be added over a thousand localities in Australia, New Zealand, Republic of South Africa, Canada, Denmark and elsewhere.

310 towns altogether) which accounted for approximately 92% of the total land and building values in the municipalities of South Africa. He then divided these towns into these five groups:

- Those which levied a flat rate in 1969 and stayed on it through 1979 (20 towns).
- Those which changed from a flat rate in 1969 to two rates (higher on land, lower on buildings) by 1979, mostly early in the period (8 towns).

- Those towns levying two rates from 1969 through 1979 (36 towns).

- Those towns which changed to LVT-only during 1969-1979 (14 towns from two rates and one from flat).

- Those towns which were on LVT-only throughout 1969-1979 (46 towns).

The following table shows the changes in construction for each of these groups from 1959 to 1979:

TABLE I - THE SWING FROM TAXING BUILDINGS TO TAXING SITE VALUE

| Taxing System | 1951 | | 1961 | | 1969 | | 1979 | | Change 1979 vs 1951 |
|-----------------|---------------|----------|---------------|----------|---------------|----------|---------------|----------|---------------------|
| | No. of towns: | per cent | No. of towns: | per cent | No. of towns: | per cent | No. of towns: | per cent | |
| Flat Rate | 187 | 58 | 179 | 50 | 114 | 37 | 100 | 32 | -87 |
| Two-Rates | 99 | 31 | 131 | 36 | 108 | 35 | 102 | 33 | + 3 |
| Site Value Rate | 36 | 11 | 52 | 14 | 88 | 28 | 108 | 35 | +72 |
| TOTAL: | 322 | 100 | 362 | 100 | 310 | 100 | 310 | 100 | -12 |

The increase in building assessments shown above were subject to inflation as well as increased economic growth.

When we compare the three categories 1, 3 and 5 which stayed on one tax system from 1969 to 1979, the growth in building value from 1959 to 1979 was highest for those on LVT-only and lowest for flat-rate towns.

When we compare the building assessments of the towns changing from flat to two rates to those that remained under flat rates, we see greater growth in those that changed to a higher land tax rate.

We also note that those towns which went from two rates to LVT-only did decidedly better than those which kept two rates.

TABLE II - COMPARISONS OF 20-YEAR GROWTH OF 125 TOWNS

| Tax Rate Category 1969-1979 | No. of Towns | Building Assessments | | |
|---|--------------|----------------------|--------|--------------|
| | | 1959 | 1979 | Increase |
| 1. Flat Rate | 20 | 520.5 | 3048.6 | 486 per cent |
| 2. Change from Flat to Two-Rate | 8 | 44.6 | 378.2 | 748 per cent |
| 3. Two-Rate | 36 | 616.4 | 4072.3 | 561 per cent |
| 4. Change from Two-Rate to Site Value Rate Only | 15 | 107.4 | 1177.2 | 996 per cent |
| 5. Site Value Rate Only | 46 | 1010.1 | 9597.1 | 850 per cent |

(all values in millions of R.S.A. rands)

Table II above refers only to the 125 largest towns in the R.S.A., but the 185 smaller towns seem to have done even better with LVT. Dunkley found that among the larger towns, the 48% taxing only land values produced 60.3% of the total land-and-building valuation, while among the smaller towns, approximately the same per-cent of the total valuation was produced by the LVT-

only towns, but they were only 26% of all the smaller towns.

Other Factors?

But what about the possibility that the extra growth exhibited by the towns with a greater amount of LVT was due to factors other than their higher taxation of land values?

Well, let's see. Most of the LVT-only towns happen to be in the predominantly Boer state of Transvaal, where most of the gold mines are; it was this area of the economy which experienced the greatest growth. This might account in large measure for the tremendous growth in the LVT-only towns; but perhaps not, because the seven LVT-only towns not in the Transvaal grew as fast as the Transvaal ones. In addition, not all the LVT-only towns in the Transvaal were near the gold-mining area, yet the far-away ones showed as much improvement as the LVT-only near the gold mines.

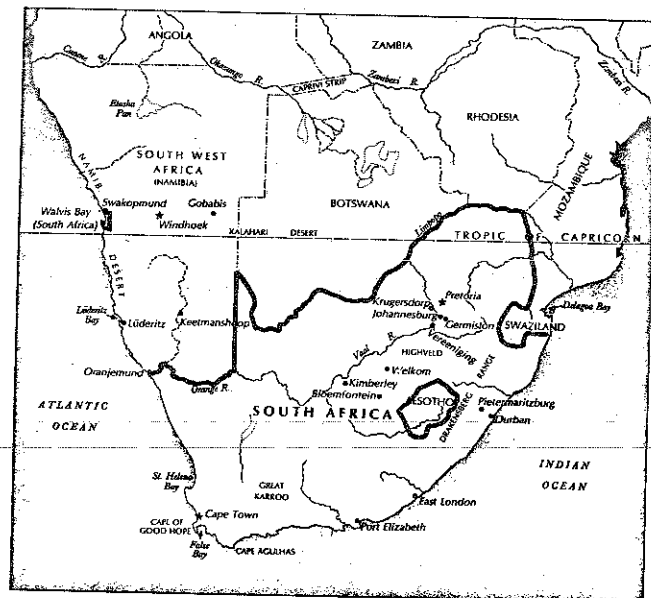
Furthermore, progress in the Transvaal would have little or nothing to do with the other comparisons made in the Dunkley study. For example, the two-rate towns grew faster than the flat-rate towns but only two of the 36 two-rate towns were in the Transvaal, and those two were small.

Nor could the Transvaal gold-mining prosperity explain why the flat-to-two-rate towns did better than the flat-rate-only towns, since none in either category were in the Transvaal.

It could be that the assessment figures given in Table II are erratic, perhaps understating building values in the early period and overstating them later. Perhaps, but then for all we know the understating and the overstating might just as likely have been the other way around.

One never can be certain that all the other relevant causative factors have been identified, but it is comforting to note that a study of 24 towns in Victoria, Australia and 5 towns in Pennsylvania yield the same results - a construction spurt following a building-to-land tax switch. And there is a clear logical cause-and-effect connection: un-tax buildings and they will be cheaper to construct, repair and operate, and when we up-tax land, we make underuse unprofitable. We should not be surprised when the facts support the logic.

And if such a moderate rise in the tax rate on land values could produce such a marked increase in new



construction, what would happen if we continued the process further? If we were to eventually replace the income and sales taxes with the land value tax, couldn't we then expect to make a big dent in the unemployment problem? In fact, it is possible to think that we won't solve that problem until we tax land values considerably more than now.

Is it not permissible to say that new construction in your town is less than it might be because of penalty taxation of property, and that people are walking around, unemployed because you are not taxing land high enough?

Godfrey Dunkley hopes to take the land value tax story to the autonomous black tribal areas in South Africa. They should be especially interested because the common ownership of land is an integral part of the black African culture.

From the Editor

• The following interesting quotation from Pope John Paul II was received by IT reader John Zuccotti, an architect and city planner: "It is not just because it is not according to God's design to use this gift (the land) in the way that its benefits (economical rent) favor only a few people, leaving the others, the great majority, excluded. More serious is the disorder and more insulting the injustice to scarcity, poverty and marginality. The same property right, by itself legitimate, must fulfill its function and keep its social utility." (Pope John Paul II, "The Land, God's Gift for all Men." Homily to the Brazilian peasants, Recife (Brazil), July 7, 1980).

• Almost all localities in Denmark tax land only and buildings not at all. The average tax rate on land is close to 4% of market value, much higher than in the average American or Canadian city (from an article by Knud Tholstrup, prominent Danish industrialist, in "Land & Liberty," 3-4/79).

• Latest statistics just issued show that in 1980 the average profit after taxes for our 2,697 largest corporations was under 5% on sales. That means that for every dollar's worth of product or service sold, the net profit was under a nickel (source: U. S. Dept. of Commerce as quoted by Citibank and Conference Board).

Significance: high profits are not responsible for high prices or inflation. But note that land prices are zooming up faster than inflation.

• The skyrocketing cost of land suitable for home building - commonly \$40,000 per site - is forcing land developers in southern California to rent land to new buyers rather than sell it to them. This saves them the down payment and land-mortgage expense.

"Single-family lots are so expensive the only way to recapture costs is to build more expensively," said one builder. (taken from two articles appearing in the Los Angeles Times, 3/15/81 and 3/22/81, sent to us by reader Frank Walker)

• President Ronald Reagan has made millions (literally) from California land speculation deals.

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City Assessor's Dept., Brisbane, Australia: "There has been no tax on improvements for the past 38 years. It caused no business disturbance when suddenly enacted and has given general satisfaction. We have no slum areas. It has been advantageous to householders, industry and the public welfare."

Does LVT Increase Tax Defaults?

Whenever the subject of land value taxation (LVT) is broached, the question of tax default is often raised. Would such a tax increase the amount of property taken over by the government because of tax non-payment?

We inquired of Godfrey Dunkley about this matter and he replied (letter of 2/26/83):

"The question of default in payment of rates (property taxes) where land value taxation applies is almost unknown here in South Africa. I asked Mr. S.J. Venter who is now president of the Institute of Municipal Treasurers and Accountants. He has been treasurer of one of our cities, Roodepoort, for seventeen years. In his experience there have only been two cases where land has been sold to defray outstanding rates; both insolvent estates."

South Africa's experience duplicates that of Australia where many cities tax only land values but have no more cases of tax default than neighboring or comparable cities which tax buildings also. In fact, studies show their number of defaults is even slightly less.

FORTUNE Smiles Again on LVT

FORTUNE, in this case, is the prominent business magazine.

The subject of land value taxation (LVT) has been dealt with frequently over the years in its pages, but in its August 8th issue, Fortune has devoted a whole article to the subject. It is flowingly written by Contributing Editor Gurney Breckenfeld (reprints are available to IT readers upon request for one dollar).

The title tells much: "Higher Taxes That Promote Development." The higher taxes refer to the higher land value taxes (higher than those on buildings) which five cities in Pennsylvania have been levying.

Of particular interest to IT readers are the increases in new construction cited in the article - increases which have followed the adoption of a higher tax rate on land, lower on buildings, in each of the five Pennsylvania cities, whereas during the same period of time, neighboring and comparable one-rate cities have suffered actual declines in new construction.

Corroboration

These figures are old stories to IT readers, but they should know that Breckenfeld and his research associate Edward Baig insisted on gathering the basic data themselves. Frankly, we were impressed by their passion for doing their own research - and we were gratified to find out that their figures were virtually the same as ours, and so were their conclusions.

This corroboration should be especially gratifying to those IT readers who might have been saying to themselves, "This IT editor is a hot LVT advocate; how can we be sure that he didn't doctor his building-permit statistics somewhat?" The independent re-

search done by Fortune should dispel this skepticism.

Backyard Gold

Breckenfeld interviewed Bill Coyne, the former councilman in Pittsburgh who played a pivotal role in persuading the city to raise taxes on land sharply in 1979 and 1980. Coyne has since been elected to Congress. "I believe we are onto something exciting," Coyne said. "I do not want to claim too much for it, but we may discover that our form of property-tax-modernization is a hidden treasure - like finding gold in our own backyard."

We are happy to report that we have received a number of requests for further information from Fortune readers. Some of them were long-time advocates who had lost touch with the LVT organizations, while others were new to the idea. A few said they had always held such views but didn't think there were any others who did.

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