Gateway to a new capital

Fred Harrison introduces his book Wheels of Fortune: Self-funding Infrastructure and the Free Market Case for a Land Tax (Institute of Economic Affairs £12.50)

Fred Harrison

Research director of the Land Research Trust

London now has the chance to jump-start a new phase in the growth of its culture and economy. The large number of multi-billion pound infrastructure plans – including 20 or more projects in the rail and underground sector – could provide an investment-led renaissance for the capital.

The alternative is to continue on the existing trajectory, which means London will be irreversibly weakened by challenges from the centres of economic power rising in the East.

The dismal prospect is the most likely outcome under the present tax regime. But London could strike out on the new path by planning a future that ensures prosperity for everyone. This agenda depends solely on political leaders having the wisdom to introduce reforms to the prices which they charge for the services that we share. Ultimately, the policy challenge is to integrate private prices in the markets with the public prices that are charged for public goods.

But let's start by gaining some sense of why existing strategies will continue to sell Londoners short. Take, for example, the case of Crossrail. The Abercrombie report of the 1940s recommended this addition to London's transport network. It was needed to help with the reconstruction of the bombed out heart of the capital. Sixty years later we still do not know how to fund an essential piece of infrastructure.

This failure of policy flows from the public's pricing mechanism. Taxes are the prices that government charges for providing services which the private sector is allegedly unable to deliver direct to consumers. But most taxes are crude devices for charging people for the use of schools and hospitals. There is no symmetry between what you pay and what you get. One result is that low income people pay a higher proportion of their income to the tax man than do the top income earners. So there is no equity in the tax system either. And as I explain in Wheels of Fortune, taxes are also extremely inefficient.

In the past, London could rely on its role as a commercial centre for an assured level of prosperity. But with the shift in the centre of industrial gravity to the Orient, the capital can no longer rest on its laurels.

Aligned with this fiscal failure is the inefficient way that we use land. The unregulated land market before 1947 was seriously deficient. This encouraged urban sprawl, with developments leapfrogging valuable sites as construction was driven more by the interests of speculators than the people who needed affordable homes and access to commercial property. So the 1947 law was introduced to plan the use of land. But that, too, proved to be equally inadequate. We still have urban sprawl and a wasteful under-use of land within our towns and cities. Something is seriously wrong with the rules that drive the land market.

The problem is that the people who benefit from the locations they occupy do not pay the full cost of the services which are delivered to them.

St Pancras showing Barlow's train shed and Foster's extension

If they did, the rental income of land would be reserved to pay for schools, hospitals, highways and all the other amenities that give land its value in the first place – including the defence of the realm, and law and order.

An attempt was made to introduce such a pricing mechanism for London in 1939, by exempting the rates on buildings and raising municipal revenue exclusively from the land that Londoners occupied. Herbert Morrison's Private Members Bill was disallowed because of its financial implications. Had the government adopted the reform, Hitler's bombers could do their worst, but they would not have thwarted the renaissance that would have flourished once postwar reconstruction had begun.

Crossrail would have been built in the 1960s. Funding would not have been a problem, because the enhanced productivity delivered by this additional link between East and West would have raised land values. And these would have been sufficient to fund the capital investment.

Canary Wharf would not have been built in Docklands. Instead, for example, a new commercial centre would have sprung up around Kings Cross in the 1970s. The blight from underused land around that station would not have damaged the capital for decades, because the owners of those sites would have been liable for charges to defray the costs of the services that made their land valuable.

As a result, with the decline of the docks, new enterprises would have automatically sprung up within the East End communities in the 1980s. Property prices would not have been driven up to unaffordable levels by the inflow of bankers, so the traditional neighbourhoods would have spontaneously renewed themselves. Ample land would have been available to provide housing for all the key workers the capital needed.

And so, we come to the present. The Mayor of London is laying plans to develop the capital over the next 20 years. Such visions tend to become binding, which means our options are narrowed the deeper the politicians commit themselves to the documents published in their names. As things stand, the range of possibilities available to Londoners today is narrowed because of the funding constraints on the provision of infrastructure.

The plan to locate tens of thousands of London families on flood plains to the east of the capital is an example. Those families would not be driven out on to sprawling estates in Essex and Kent under the efficient pricing system. As it is, the government does not know how to fund the infrastructure for those conurbation communities.

Alternatives are constantly in the making. We need to learn the secret of how options are expanded by the provision of transport infrastructure. They could pay for themselves while widening the job and leisure options for people within London. Consider, for example, the enormous potential for developing the area located between the West End and the City if Crossrail and Thames Link 2000 were constructed. The proposals include the construction of stations for each of these lines in the Smithfield meat market area. Linking the two stations together would attract people from all four points of the compass into an area around Clerkenwell and Holborn which has enormous development potential.

The intersection of those two stations would raise residential and commercial rents by an enormous factor. Old buildings would be demolished or rehabilitated, and rents would rise in line with the increased productivity of the economy. If those rents were tapped to fund the two lines, the railways would not be a burden on taxpayers.This rejuvenation is long overdue. When I worked in Fleet Street in the 1980s, I could still walk past sites that had been levelled by Hitler's blitzkrieg. Under a regime in which people paid their fair share for the services shared in common, we would not still be waiting for this ribbon of real estate, trapped between Kings Cross and the Thames, to be fully redeveloped.

The lessons of history have still not been learnt. Witness the Blair Government's mistake with the reintroduction of a development land tax (called Planning Gain Supplement). This is supposed to capture some of the uplift in land values to fund infrastructure. But as with its four previous attempts, this, too, will achieve little more than gum up the construction industry.

Land owners have already declared a determination to withdraw their sites from use to avoid paying the tax. This makes the planning of future developments difficult for both public agencies and the development industry. Instead of compact communities enjoying all the infrastructure they need, urbanisation will continue to spread itself thinly, dribbling out the under-funded public services.

Government is working with an obsolete business model. Real estate development, when linked to facilities like the new rail hub at Stratford, releases enormous land value which could be used to fund new infrastructure. Olympia and York (re-incarnated as Canary Wharf) showed the way when it declared its willingness to pay for what became the exten-

The 10-Year Transport Plan

	Investment and Expenditure: 2002-2011 (£bn out-turn prices)			The Impact of Fiscal Policy	
	Taxpayer funded expenditures	Private Investment	Total	Land Value leakage	Dead-weight Loss
Road, Railways & Other Transport	£124bn	£56bn	£180bn	*Between* £185bn *and* £540bn	*Between* £37bn *and* £248bn

Source: *Wheels of Fortune* (2006 p.168)

The Stratford City site covers 73 hectares and has Stratford International station at its heart.

sion to the Jubilee Line to serve its estate.

Instead, all political parties are wedded to the tax regime that imposes enormous leakages and losses on Britain. The leakages are the land values that seep out of the enterprise economy – which ought to be recycled back into paying for infrastructure. The losses are the costs of the distortions that stem from conventional taxes. These, according to the Treasury's own yardstick, cost Britain something like £140bn in wealth and welfare every year.

If we abolished the bad taxes, which deliver deadweight losses, and raised revenue direct from the rent of land, we would staunch the leakages and terminate the losses. But the Treasury needs to provide quality data to animate an informed debate. In the table, I illustrate the information problem by indicating the range of leakages and losses associated with the 10-year transport plan that Deputy Prime Minister John Prescott promoted. The uncertainty over the scale of the leakages and losses is unacceptable in what the government promotes as a knowledge-based economy.

In the past, London could rely on its role as a commercial centre for an assured level of prosperity. But with the shift in the centre of industrial gravity to the Orient, the capital can no longer rest on its laurels.

London should abandon the plan to expel people into Thames Gateway developments. Instead, City Hall and Westminster should work together to open the gateway to a new capital. But to raise London's productivity to the competitive levels required in the 21st century, we first have to consign to history the taxes that damage its economy.