

Moving towards Active Land Use Policy

Ronan Lyons

*Department of Economics, Trinity College Dublin & Spatial
Economics Research Centre, London School of Economics*

1. Introduction

Ireland, and the Greater Dublin area in particular, faces a housing crisis. Between the 2011 and 2016 censuses, the country added fewer than 20,000 new homes, between 10% and 15% of the required demand in that five-year period. The Greater Dublin Area added roughly 650 households a month between the two censuses but in none of those sixty months were 650 new dwellings added in the eight local authorities that comprise the Greater Dublin Area. In short, with a rapidly growing population, inward migration and demographics shifting towards smaller households, Ireland enjoys strong demand for new housing. However, the supply response – perhaps the single most important barometer of the health of a housing system – has been close to zero.

Housing is now, as of late 2016, a major priority for the Government, with a Cabinet-level Minister of Housing and an action plan on the area, *Rebuilding Ireland*, launched in mid-2016. However, despite the elevation of the importance of housing, there is scant evidence of sufficient improvement in housing supply, with 2016 likely to see just 10,000 new homes started, less than one third the required amount.

There are four core policy areas in relation to housing. The first is the management of credit conditions, done through what is now termed macro-prudential policy. This limits the extent to which asset factors, including expectations of capital gains, can affect the price of housing (and other real estate assets). In short, sensible macro-prudential policy caps housing prices relative to the real economy.

The second area of housing policy is the efficiency of the construction sector (whether providing market or social housing), measured principally in the cost of building new homes, including apartments. This cost should be in line with the cost of construction in other similar-cost economies, such as our Eurozone peers. The management of construction costs effectively caps them relative to real economy: it is the counterpart of macro-prudential policy, as without a policy in relation to construction costs, price may be less than cost and no new supply will be provided even if it is badly needed: a reasonable description of the situation in Ireland currently.

The third area of housing policy relates to social housing. Even in an economy with well managed housing prices and costs, the two areas above, there will

always be a substantial fraction of the population with incomes too low to be able to cover the cost of their accommodation needs. Optimal policy would link the provision of social housing to the gap faced by each household between the disposable income they can sustainably spend on accommodation and the cost of their accommodation needs.

The final area of policy relates to land use. Many cities in high-income countries have seen the price of housing rise dramatically over the past fifty years and there is widespread agreement that the underlying cause is land use restrictions. A comparison of populous high-income cities with and without such restrictions lends weight to the assertion that no city has reached a point where it cannot house its population at sufficient density that the price of housing would be close to construction cost. In other words, on a per-household basis, there is no reason – other than policy – for the cost of housing in popular cities to be so high.

This paper focuses on the management of land, especially urban land, in the context of the Irish housing crisis and makes two core arguments. The first is that land is core to the delivery of the major goals that policymakers in Ireland (and elsewhere) have. In particular, it argues that policymakers should have as their one of their main goals the maximisation of the aggregate value of land in Ireland – this goal is consistent with maximising economic opportunities available to those resident here and thus their living standard.

The second argument follows on from this. Just as there can be unemployed people, so too can there be unemployed land. This goes further than justifying policy interventions to minimise unemployment (of either people or land). Rather, if policymakers are to deliver the best possible standard of living to their citizens, it is required that they actively manage land, particularly scarce and valuable urban land. This is analogous to the move across the OECD in the last generation towards active labour market policies to remedy unemployment.

The policy implications are clear. Local authorities should be required to have action plans for ensuring the land under their remit is used well. This will include general policy interventions, such as the taxation of land based on its underlying economic value and the encouragement of frequent change of use, as opposed to the current system based around *status quo* bias. This will also include specific interventions, such as identifying the most valuable unused and under-used sites in a local authority's area and action plans addressing why those sites are less than optimally used. This is particularly important for Dublin City Council, which is responsible for the largest fraction of valuable land.

The rest of this paper is split into four sections. The following gives a general theoretical background for thinking about the maximisation of land value as a valid policy goal. The third section draws strong parallels between active labour market policies, which have become popular in high-income countries over the

past two decades, and the management by local authorities of their stock of land. The fourth section works through a simple example in the Dublin context and outlines the shift in policymaker mindset required for policy in relation to urban land to contribute solving the Irish housing crisis. The final section concludes.

2. Land and Policy Goals

Together with labour and capital, land is one of the three key inputs into the economic system. Just as the term human capital recognises that not all hours worked give the same output, as people have different skills, the same can be said of natural capital. The term natural capital thus includes land, energy, and other resources from the earth. With human and natural capital thus defined, physical and financial capital comprises all other stocks of wealth.

This three-way divide between human, natural and other capital is quite similar to textbook descriptions of the economic system, including what is taught in introductory economics courses. However, this differs from much current economic research, which for simplicity divides stocks into capital and labour. The elision of financial and natural capital hides a crucial distinction between the two: financial capital is typically very mobile, particularly in the absence of countervailing policy – but natural capital is very immobile.

This has real-world implications for policymakers. Where policymakers adhere to a two-factor set-up, capital is classed as mobile and labour as immobile. This is ultimate motivation behind policy systems based on attracting foreign direct investment (FDI): by increasing capital, basic economic theory says that this boosts the productivity of labour – and thus living standards. Policies relating to land use, including for example the tax-promotion of home ownership, are viewed as entirely domestic policies (similar to the redistribution of resources).

However, in a three-factor set-up, human capital is in an intermediate position: less mobile than financial capital (due to policy restrictions on migration for employment), but more mobile than natural capital.¹ The goal of policymakers is less clear in this setting: if their aim is solely to boost the living standard of their citizens, “optimal” policy could involve sending some of the resident human capital elsewhere.

This, in fact, has been core to raising the living standards of Irish people for centuries. The Irish who left between the Great Famine and the Great War moved to economies that enjoying higher standards of living. Contrary to much of nationalist economic thought, their departure also raised the living standard of

¹ This analysis extends to stylised treatment of skill; for example, distinguishing between skilled and unskilled labour, the former being more mobile. Analogously, it is possible to distinguish between financial capital (typically termed portfolio investment) and physical capital (direct investment), the former being more mobile. In reality, factor mobility should be treated as a spectrum. The discussion here can be thought of as the average mobility of each factor.

those who remained, with Irish wages converging rapidly with those of the UK and the US in the late nineteenth century. Peaks of emigration in the 1950s, 1980s and early 2010s can be seen in a similar way.

This is a policy which is viewed differently politically than economically. It is viewed as the job of policymakers to ensure that their citizens can enjoy a good standard of living *in that country*. Thus, it is *de facto* the target of policymakers to maximise the value of natural capital (specifically the value of land). The more people live on a set quantity of land – for example the 7 million hectares that make up the Republic of Ireland – and the greater the economic opportunities available to them, the more valuable that land will be.

It is important to distinguish this aim of maximising the aggregate value of land from the artificially inflated value of much urban land currently in Ireland and other high-income countries. This is principally a distinction between aggregate and per-household values. For example, under current policies with substantial land use restrictions, sites with one family home in a central area are very valuable, as policy restrictions give them an artificial scarcity – as well as protection from that site being recycled to greater use, in most cases.

The same site converted from one three-bedroom dwelling in a central location to a six-storey multifamily dwelling gives far greater benefit to society, with up to 100 people living on the site, compared to perhaps four people previously. In the case with just one dwelling, if the dwelling is worth €600,000 and the rebuild cost is €350,000, the site is worth €250,000. However, the same site with 40 apartments might have a value of €1 million. This is both in aggregate more valuable – and also on a per-household basis far more affordable, with a per-household cost of land of just €25,000.

3. Learning from Active Labour Policies

Over the past generation, policymakers in most high-income countries have moved their labour market policies away from what are now termed passive supports – in particular unconditional income supports for those unable to find work – to active labour market policies.

These policies can be thought of as the human capital counterpart to policies around the attraction of FDI for economic development purposes. In other words, to maximise economic opportunities and the standard of living, the policymakers aim to maximise the use of human and financial capital within the economy. Practically speaking, this means quite resource-intensive interventions – both to attract capital and to minimise the unemployment of labour.

Active labour market policies are aimed at people of working age not in employment but who are willing to work. They are distinguished from passive labour market policies because they are based on the principle of mutual

obligations: the state has an obligation to ensure that the citizen has an adequate income, while the citizen has an obligation to ensure they do their best to (re)gain employment.

There are four main types of active labour market policy. The first is for the government to simply employ the labour itself: compared to passive benefits, there is at least the output produced by the new workers to offset the cost. The second is to subsidise private sector employment, for example through start-up grants, assistance for self-employment, or wage subsidies. The third is to engage in training or other up-skilling, in order to increase the human capital of those unemployed – this includes training to move workers across sectors.

The final type of active labour market policy is job search assistance, where the state takes an active role in pairing up the unemployed worker with a vacant post. In relation to unemployed labour, the evidence is largely that job search assistance has the greatest short-term impact and that training, while expensive, has the greatest long-term impact and value for money.

The phrase “assuming full employment” is typically thought of as referring solely to labour, with capital being mobile so if it is not used in one economy, it will move elsewhere. However, in principle, fractions of all stocks of wealth – human capital, financial capital and natural capital – can go unused. Just as there is a human capital counterpart to the policies aimed at maximising the stock of financial and physical capital at work in an economy, so too it is possible to conceive of active land use policies, in particular relating to the most valuable percentile of land in Ireland.²

Efforts should focus on this fraction of the land as its value indicates that it enjoys economic opportunities that are not replicated elsewhere. Each of the four types of active labour market policies can be recast as a potential active land use policy – and similarly, there are some types of policy that offer far greater potential for social return on investment than others.

3.1 Public Sector Uses

Perhaps the simplest form of active land use policy is for the public sector – either national, local authority or semi-state – to use land. However, a key difference between labour and land is the element of agency: people can reassign themselves into activities or sectors that best reflect their talents. Particularly given restrictions by various levels of government on how land may be used, the problem of land use is as much one of under-use (relative to optimal value), rather than full unemployment. Indeed, many of the worst examples of land use, relative to optimal usage, are public sector uses. For example, RTE occupies

² Dublin city (the entire contiguous city area) comprises just 0.5% of the land area of the Republic of Ireland.

roughly 25 acres of some of the most valuable residential land in the country, with Dublin Bus occupying a further 8 acres across the road.

Similarly, in the valuable Grand Canal Docks area, five acres are taken up by another Dublin Bus depot and an An Post sorting office. The Department of Defence also occupies large and valuable sites in Dublin 6 (Cathal Brugha Barracks, roughly 30 acres) and Dublin 7 (roughly 40 acres across McKee Barracks, the military hospital and related land).

In short, given the immobility of land, valuable land is rarely completely unemployed – rather it is underemployed relative to its best use. Here, particularly given the lack of financial autonomy on the part of the individual public sector units on the site, the public sector is more likely to be part of the problem, than of the solution.

3.2 Private Sector Subsidies

An alternative would be for taxpayer resources to be spent subsidising private sector uses of sites. Again, this should be thought of as changing use of a site as much as bringing empty sites into use. A number of initiatives exist in this space, particularly for start-ups or other small indigenous firms, including the Digital Hub in Dublin 8 and other sites have been suggested, including Pigeon House in Poolbeg, the former power generation facility.

Tax reliefs such as Section 23 can be viewed as private sector subsidies for land use, as they create a wedge between the social cost of a site (including, for example, supporting infrastructure) and its private cost. This led to the excessive construction of residential property in areas where there was insufficient long-term demand, particularly for the smaller property types that were predominantly built.

There is a vital distinction between subsidising the use of a site and the use of the tax system to encourage its most valuable use. Probably the single most powerful tool in the policymaker's toolkit, in relation to encouraging the optimal use of the stock of land, is the land value tax. This tax is levied on the rental value (or equivalently on a percentage of the capital value, typically 5%) of the site at its highest-value permitted use. This neutrality with respect to the nature of the use, and focus instead on the value of the use, is a strong incentive for the use of the site to be continually reconsidered.

One concern in relation to land value tax is that it might lead to over-construction, i.e. because the tax is entirely on the site, rather than on any improvements on it. However, there are two checks on this. The first is the financial constraint. In an environment with sensible macro-prudential policy (as per Section 1 above), the capital value of a project will be closely related to its real economic value. If there is insufficient demand for height above say 3-4 stories, as will overwhelmingly be

the case outside of perhaps the most valuable 0.1% of land in the country, there will be no supply of such property.

The recent economic history of Ireland, however, may create a fear about the economic literacy of those involved in development. Mostly, this is ill-founded, as Section 23 and related reliefs created a “free bet” for developers, which is what caused excessive levels of development. Nonetheless, a second check is the presence of local authority development plans and zones, which can set maximums for certain districts.

3.3 Change of Use

The third area of active labour market policy is the training of those who are unemployed, to eliminate a mismatch between those looking for work and vacant posts. Typically, this mismatch is a fundamental one, relating to core skills or sectors of the unemployed compared to the vacant posts. The analogue when dealing with natural, rather than human, capital, is restrictions that are put on the sectors to which a site can be put. These are, almost by definition, a result of policy rather than immutable circumstances. Therefore, a change of mind-set is required, if Irish local authorities are to adopt an active land use policy.³

Currently, local authorities regard themselves as custodians of the status quo: any suggested change of use outside of the development plan is unlikely to be regarded favourably. This misunderstands the nature of such suggested changes. Suggestions to change the use of site to something not previously considered by policymakers are not only desirable, they are essential in the proper use of a country’s (or city’s) scarce endowment of valuable land. It is precisely this way that unanticipated changes to preferences surface from bottom up.

Even without the implementation of a land value tax, policymakers should audit major sites against a list of potential uses and assess the value of the site for each. This will enable local authorities to respond to unexpected requests to change the use of particular sites already in use. More generally, this will start a long overdue process in Ireland of reassessing what activities should be based where.

As the examples in Section 3.1 suggest, there are numerous instances of valuable sites being under-utilised due to a status quo bias, including those owned by the Department of Defence, Dublin Bus/Iarnrod Eireann, and other state-owned enterprises such as An Post and the Dublin Port Company, as well as core administrative units of central and local governments. There are also numerous privately owned or disaggregated sites, such as the Dublin Industrial Estate, where the Cross-City Luas extension will terminate, or similar facilities in a semi-derelict state at Davitt Road, close to the Red Luas. In brief, policy in relation to

³ The term ‘active land use policy’ is preferred to ‘active land market policy’, which is the more direct counterpart as the full range of land uses include market and non-market activities.

land use needs to change so that sites such as these are reviewed every five years; the past few decades have shown that, without such an automatic check, future use is overwhelmingly determined by past use.

3.4 Joint Responsibility

The fourth area of active labour market policy relates to job search assistance: in other words, the government and the individual concerned have a joint responsibility to address the unemployment. This translates readily to active land use policy: the government (either central or more usually local) and the site-owner have a joint responsibility to ensure the site is optimally used.

As discussed above, by far the simplest way to ensure that the site-owner's interests are aligned with those of broader society is to impose an annual land value tax. This would replace commercial/industrial rates, stamp duty and development levies, as well as the proposed vacant and derelict site levies. It would apply to all land, other than land used for residential or agricultural purposes, including land zoned for development and land in public ownership.⁴

The principle of a land value tax is that it is taxed based on the most valuable allowed use of that site. This brings in the role of the government (typically at local level), which determines the allowable uses of each site. This would prevent owners of sites with little or no redevelopment prospects (for example due to the structures being protected) being overly burdened by taxation. The quid pro quo for such a system is that zonings would have to reflect the realities of a particular site. There is little sense in zoning a site for medium-height apartments if, through the effect of other regulations or restrictions, the site will never be developed for such a purpose. This is explored in more detail in Section 4.

4. A simple example

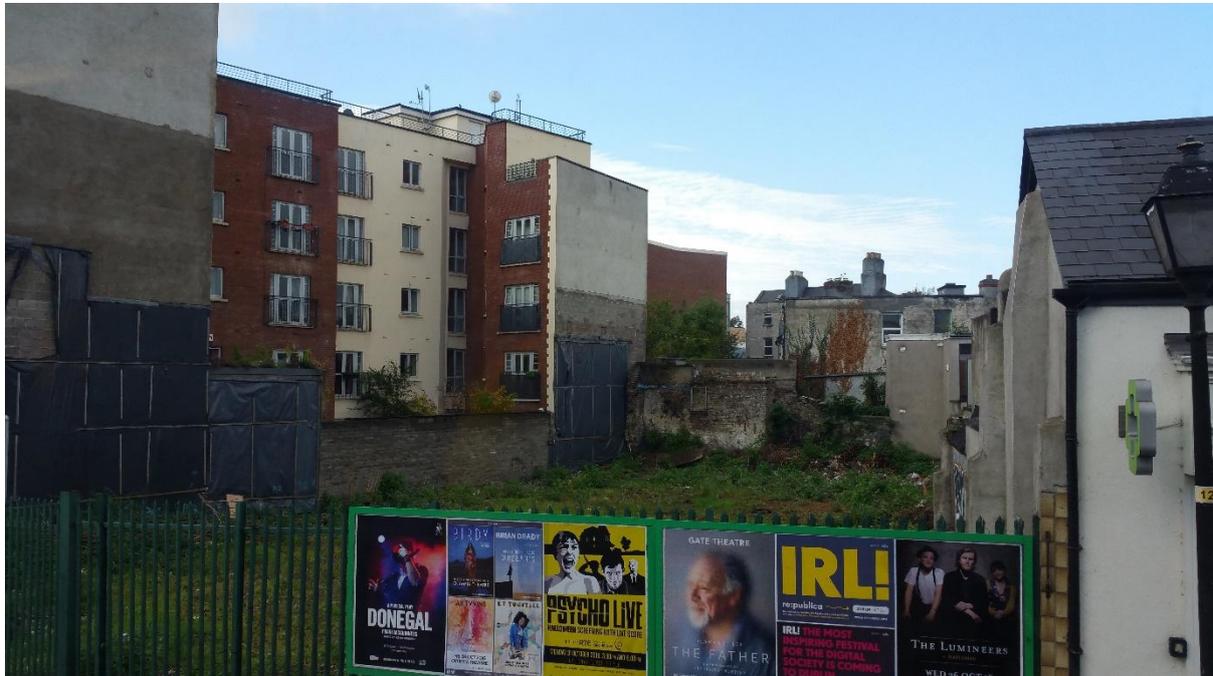
An example is given in the photograph below. The site measures roughly 700m² and has been for sale for some time. It is located between Smithfield and Stoneybatter, both areas with strong residential demand, particularly by renters. However, the site remains for sale. Under a land value tax system, this would be assessed based on how many apartments would be allowed to be built on this site and, subtracting construction costs, the value of site can be estimated.

It is quite likely, however, that this site has – by that method – a negative value. It costs roughly €250,000 to build a two-bedroom apartment to Dublin City Council's minimum specifications. In addition, there is a prescribed ratio of one-, two- and three-bedroom apartments for newly built apartments blocks, as well as regulations for basement car-parking spaces and lifts. Other restrictions include the height of ceilings, the depth of balconies, the fraction of storage space within

⁴ A true land value tax would also apply to residential and agricultural land, but given the extremely low levels of recurrent taxation on such lands currently, this is not envisaged as politically feasible.

units and the orientation of the typical unit. In particular, Dublin City Council requires that the vast majority of units are dual aspect and that no single-aspect units can face north or east.⁵

Figure 1. Site for sale at Stoneybatter, Dublin 7



To examine this latter restriction in more detail, the nature of this site means that there is very little scope for south-facing or west-facing apartments. Taken all together, and by the revealed action of those in the market – i.e. this site remains for sale – these limitations have rendered a viable site unviable.

For each of the many instances like this across the city, each site should be assigned a Case Officer. That officer would be required to assess the site, including its peculiarities and the likely demand for various uses on the site, together with an action plan that would increase the viability of the site. This action plan would be developed in consultation with the site owner and effectively be an evaluation of the opportunity cost of local authority targets for the site. On publication of this plan, the land value tax would be imposed.

5. Conclusion

Prior to the Celtic Tiger period, local authorities had significant hands-on experience in the active development and management of real estate, including sites and multifamily residential developments. The ideologically-driven hollowing out of social housing, among other changes since the 1980s, has left local authorities with little internal understanding of the realities of the value of

⁵ The justification for such restrictions has never been explained, nor has their opportunity cost been calculated.

sites, either in use or not in use. Similarly, there is little understanding of the opportunity cost of regulations and minimum standards imposed.

The publication of targets, for example relating to floor space, orientation, balconies or lifts, is a sensible policy response to guide development in a certain direction. However, the imposition of binding minimums in the same areas ignores the realities of sites and of development. It creates a dangerous gap between the accommodation for those on highest incomes and others in need of new homes.

This paper has introduced a new concept for how policymakers manage the stock of natural capital at their disposal, in particular scarce and valuable land. It is termed Active Land Use Policy, as it draws directly from the progression of unemployment benefits to Active Labour Market Policy. Furthermore, the four kinds of Active Labour Market Policy have analogues in land use. As with under- and unemployed labour, direct public sector use for its own sake or simple subsidies for private sector use will not address the underlying policy failures. In particular, the evidence from Dublin's existing patterns of land use is that the public sector is a key culprit when it comes to under-utilising valuable sites.

Rather, policy in relation to land use should be recast along two principles. The first is that, by default, the use of all major tracts of land in a local authority should be automatically reassessed every five years. This is particularly important in urban local authorities, and in Dublin City Council, where the vast bulk of valuable land is situated. To take one prominent example, six of Dublin Bus's seven depots today can trace their ancestry back to the Dublin United Tramway Company, founded in the 1890s and which itself inherited the depots from its constituents, who bought the sites when they were at the edge of the city.

The second principle is one of joint responsibility. Just as the owner of a site has a responsibility to put it to good use – something that should be internalised via a land value tax – the local authority has a responsibility to bring that site to its best use. In particular, as the example with the site in Dublin 7 showed, there may be policy failures that are preventing the site from being put to its best use. This is something that needs to be done at the site level, just as there are Case Officers at the individual level for those who become unemployed.

Ultimately, in a world with mobile capital, partly mobile labour, and immobile land, having policies in relation to attracting capital and employing labour without having policies to fully utilise land is incomplete. This gap in public policy is at the heart of the significant artificial inflation of land values in Dublin and many other high-income cities over the past two generations. It is now recognised that this threatens international competitiveness, social cohesion and the living standards of the younger generation. Switching from passive to active land use policies is the best way to remedy these threats.