

*Taxation of Site Values*<sup>\*1</sup>

By C. F. BICKERDIKE

The modern demand for taxation of ground values is based on alleged injustices of the rating system. Landlords benefit from municipal improvements, and therefore ought to contribute specially towards the expenses of them; or "tenants have to pay twice over for their improvements." These are the popular arguments.

What exactly is meant by "benefit" when appeal is made to the "benefit principle"? If payment for municipal services is to be like payment for all other things, the only sort of benefit to be considered is direct use. Those pay for domestic gas who enjoy the light derived from it, and are responsible for its consumption. One does not trouble about indirect effects, though they are just as complicated as the indirect effects of a rate levied to pay for the lighting of streets. In either case, the comparative dearness of gas in one place may be prejudicial to rents, and we may if we like try to estimate what portion of the gas bill, as of the rates, falls upon landlords or leaseholders. Or the supply of gas may prove such a boon that it attracts people to the neighbourhood, and landowners may benefit. All the same, using words in their ordinary sense, we are justified in saying that a man pays his own gas bill, and few doubt that he ought to pay it. On ordinary commercial principles, those who get the direct use of a thing make the direct payment. Municipal services then should, on ordinary principles be paid for by those for whose first-hand benefit, or on whose responsibility, they are provided, *i.e.*, the whole body of inhabitants. There may be difficulty in apportioning the payment amongst those inhabitants, but that does not affect the question at issue. There is no question of apportionment between the body of inhabitants, and the body of leaseholders and of landowners.

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<sup>1</sup> The greater part of this paper is taken from the essay which won the Cobden Prize at Oxford this year. Owing to want of space, the latter portion dealing with the practical proposals of Mr. Moulton, the London County Council, and the Royal Commission Minority, has been omitted, and a summary only of the earlier part of the essay is given.

Misconception has arisen from failure to recognise that the benefit, if any, derived by landowners, is indirect, and does not exist at all unless the money value of improvements is in excess of the cost; it is simply the producer's surplus, like the rest of their rent.

Is it possible or desirable to appropriate any part of this surplus? Here we come to the well-known "unearned increment" argument. Properly speaking it has nothing to do with the incidence of rates, and the discussion of it on its own merits is reserved to another place. Many people, however, think that the surplus due to municipal enterprises is very considerable, and is chiefly responsible for the growth of land values, and justifies an attempt to improve upon ordinary commercial principles. The importance of this factor in the growth of land values is, however, usually much exaggerated through a hazy idea that the value of an improvement has a direct connection with its intrinsic utility. Really, utility enters into the value only in the same kind of way as into the value of wheat. Most of the surplus of intrinsic value, so to speak, above cost is consumer's surplus. The mistake arises from forgetting that most improvements are not peculiar to any one place, and only those places which have some natural advantage above the average yield a surplus. Apart from the growth of population and industry it is doubtful whether aggregate economic rents would be increased at all by improvements which make towns healthier and pleasanter. Professor Marshall and Ricardo have discussed the effect upon agricultural rents of improved processes, and the conclusion of the former is, that though Ricardo is wrong in arguing that such improvements must necessarily lower rents, that result is quite probable. Similar reasoning may be applied to urban rents. (For a discussion of the validity of applying to urban rents conclusions based on arguments from agricultural rents, see further on.)

The conclusion is that increments of rent due to the actions of public bodies cannot possibly be dissociated from that due to the general growth of population and business. The "unearned increment" argument must therefore be separated from the question of the justice of ordinary rates.

It is quite evident, however, that the advocates, and even the opponents of the rating of ground values do not usually recognise the fact that the one solid foundation for the proposal is this argument from the "unearned increment." It is necessary to examine, therefore, the less vulgar sources of misconception. Even amongst economists the general principle that as regards occupiers in toto the payment of rates is like other payments, is often much obscured owing to the way in which the subject is approached. First, we have the principles of benefit and ability men-

tioned without any discrimination between direct use and indirect advantage; then follows an intricate discussion of the incidence of a rate assumed to be purely onerous, and the verdict as to the right and wrong of rates is made to turn on the answer to the question whether an occupier shifts any definite part of the burden on to his superiors. The benefit is hazily spoken of by both parties as something shared between occupier and owner, and controversy turns on the distribution of the burden of payment. We lose sight of the fact that there is no benefit to the owner until the occupier has been at least compensated for his payment. This way of treating the question introduces many pitfalls, the detection of which is the theme of that part of the essay which now follows.

It is unfortunate that, amongst the questions put to the experts by the Royal Commission on Local Taxation, there is none which asks directly about the incidence of benefits. Consequently the question is treated much more vaguely than that of onerous rates. Professor Marshall says, "The ultimate effects of such rates (*i.e.* beneficial rates) may be discovered fairly well by discovering the effects of onerous rates and reversing those." But he leaves the reader to do the reversing. One result is that an erroneous one-sided view is frequently taken of the effects of "friction." In discussions of the incidence of onerous rates much stress is sometimes laid upon the difficulty which occupiers experience in shifting any part of the burden upon owners. Ignorance, unwillingness to move, and length of leases are made much of. Hence friction is regarded as a force which acts against the interests of the occupier. Even in regard to onerous rates it might be pointed out that friction acts both ways. If occupiers in highly-rated places are unwilling or unable to move to the more low-rated places, it is to the disadvantage of landlords in the latter. But it is more important to remember that in so far as friction is effective, it also tends to prevent landlords in places which have been improved from reaping the advantage. If people are unwilling to go to the expense of moving where onerous rates are high, they will probably be equally unwilling to move in order to go to a neighbourhood where the results of beneficial rates more than make up for their amount. If leases in the latter place are long, the owner cannot raise his rent easily. It is a favourite device of the partisan to fix attention upon the onerous rates when the occupier is talked about, but when the owner is brought in, rates are thought of as producing great conveniences. If it be a fact, as Mr. Costelloe says, that ratepayers fail to appreciate the value of the services rendered to them by municipal expenditure, whilst they fully appreciate the burden of payment, this makes it the more difficult for landlords to get any indirect benefit.

Another circumstance which is made the basis of a complaint that landowners derive undue benefit, is the system of paying sinking funds for the extinction of debt.

Let us disregard at first the complications of intermediate leaseholders, and suppose landowners to build houses and let them directly to tenants on short leases. If now an improvement is made with borrowed capital and a sinking fund established, it does not matter whether the owner or the occupier pays it. It is an element in the supply curve anyhow. On whom the incidence of the sinking fund rests depends upon whether it is a peculiarity of one place or a universal system. In the former case, the owner bears the burden, for this improvement would be charged for at a higher rate than elsewhere. If the system is universal, the occupier substantially bears it. It means that these conveniences have a higher price than would be the case if no sinking fund were judged necessary, and the only effect upon owners would be the result of a possible diminution of demand for building accommodation. Similarly, it must be remembered when the capital has all been paid off, the same considerations have to be taken into account in deciding who has the benefit of the improvement unaccompanied by a rate. If the whole thing is confined to one neighbourhood, the owner gets the advantage, which is just, since he or his predecessor bore the burden. If the system is general, the occupiers stand to get much of the benefit of cheaper accommodation in precisely the same way as their predecessors stood to bear the burden.

If sinking funds really are too large, the issue is between the present and succeeding generations. Whatever part the occupiers bear is for the benefit of future occupiers, and, whatever part the owners bear is for the benefit of future owners. People are very apt to assume tacitly that the burden is borne like a universal onerous rate, but when the advantage of having no rate to pay is thought of it is treated as a peculiarity of one locality.

When length of leases is taken into consideration, the matter is not quite so simple, for the length of the lease in this case acts only one way. If the burden is imposed after the leaseholder has made his contracts, of course he cannot shift it backwards, but when the time of freedom from rate comes, it is not an unexpected event. If the lease has been taken after the imposition of the burden, the fact that the burden would cease entirely in course of time would presumably have been allowed for. Thus the long leaseholder may have a small grievance. The ordinary occupier is not affected. These long leaseholders, however, are not usually supposed to deserve much pity, since the progress of towns has usually been quite as much an unexpected event as the imposition of sinking funds.

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Apart from the more obvious popular fallacies already mentioned, there is confusion on the subject of benefit, owing to the fact that payment for municipal services cannot be made to correspond to payment for ordinary services in all particulars, for two reasons. Firstly, the majority of such services, though partially beneficial, are not so entirely. Secondly, even if they were purely beneficial, the benefit is too generally diffused to allow of the apportionment of payment on ordinary principles amongst those who directly enjoy it. It is only when regarded *in toto* that one can say that ratepayers pay for what they directly use. In the case of houses, each individual can feel that he has paid in proportion to what he has got. It is the same with gas and tramways. But in the case of street-lighting, though the majority of ratepayers presumably admit that taken altogether they have their money's worth, there is nothing to prove directly to each individual that he in particular gets his money's worth; so each one thinks that the advantage accrues to every one else. The difference between beneficial and onerous rates is largely a matter of degree. Some things, such as lighting and cleaning of streets, are advantages visible to the eye; they may be taken into account when a man is choosing a house, though they are apt to be forgotten when the rate-collector calls. Other things, such as police, schools, town halls, are also supposed to be worth the money to the community as a whole, but are not likely to be thought of very seriously by house-hunters; they are mainly then onerous. Finally, there is the poor-rate, which the majority of people approve of for unselfish reasons only. It is clear that the more the object for which the rate is levied approximates to an ordinary commodity desired by individuals for selfish enjoyment, the more possibility is there of indirect benefit to landowners. Hence, the maximum possible benefit will be found by assuming that each individual fully appreciates the money value of an improvement. If in this case the landlord's benefit is merely indirect and vague, *a fortiori* it will be the case with the majority of rates, and in many of them the net result is burdensome, at least so far as landowners are concerned. It has already been argued that a rate assumed to be purely beneficial is neither more nor less just to occupiers as a body than any other payment for commodities and services. The only effect, so far as the question of landowners is concerned, of introducing the burdensomeness into the discussion, is to minimise still further the benefit argument for taxing land values. It is useful to remember that if an improvement is really sufficiently beneficial to benefit landlords, it would be worth their while, if they could agree amongst themselves, to execute the improvement at their own expense. This test will frequently make it evident that the supposed benefits to owners are much more doubtful than people

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often imagine. Very few rates are really payments for commodities like ordinary commodities for which people pay a money value equal to marginal cost of production.

But there are some who maintain that apart from the benefit question, purely onerous rates should come partly from ground landowners. This idea is undoubtedly due to the popular habit of regarding a rate as a tax on property, intended to fall upon owners of property. Hence the discussion about the shares of taxation which falls upon real and personal property, or movables and immovables, the futility of which is recognised by the Royal Commission. After all, when one asks why owners of property should be taxed, the answer must be because they benefit, so that the argument about "all classes of property contributing equally" is really, so far as it means anything, the benefit discussion over again.

The intricacies of the question of incidence have had something to do with the prevailing confusion about rates. There has been much controversy over the question whether the occupier shifts any appreciable portion of the rates to the owner, and the most hotly argued question frequently comes to be regarded as the most important. It may fairly be asked why the question should be considered important. If the occupier is intended to pay, the only people who might feel interested in the question of incidence are the owners, who might urge a grievance if the tax is shifted on to them. There is some plausibility in the argument that the share of onerous rates borne by leaseholders and ground landlords is a compensation for the benefits derived from other sources, a sort of indirect taxation of unearned increment. On this question, as on the benefit question, popular opinion has been full of fallacies. Estate agents declare in one breath that onerous taxation falls practically on owners, and in the next they say that to divide rates between owner and occupier would be useless. "We should merely put up our rents by that amount."

Hopeless inconsistencies and disagreements make it impossible to attach much weight to the opinions of the "practical men." It is no use trying to find out by observation whether the addition of a few drops of water makes any difference to the height of water in an agitated bucket.

Unfortunately the highest economic authorities are not quite agreed. Professor Marshall, in reply to the Royal Commission (*Memoranda*, p. 117), says, "If a uniform imperial tax be levied on the annual value of all land and buildings, the building part of it tends to settle on the occupier, or on his customers if he uses the building for trade purposes; but the site part of it tends to settle on the owner for the time being; that is, on the interim owner in so far as it is imposed during his lease; and on the ultimate owner when he comes into possession. If, however, agricul-

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tural land is exempt from the tax, then the tenant escapes only that part of the site tax which is assessed on the excess of the value of the land for building uses over its value for agriculture."

This has all the appearance of being a careful statement, and it is difficult to avoid the conclusion that Professor Marshall really gives his support to Mill's division of a tax on rent into two parts, the incidence of each of which may be traced separately, so that any such tax is definitely, apart from friction, a tax on economic rent which the owner cannot shift. According to this view, if the tax is uniform and leases very short, the owner pays at least a fraction of the tax, the fraction being the ratio of economic rent to the whole rent, quite independently of any additional loss due to diminution of demands for buildings resulting from the other part of the tax.

Professor Edgeworth, in the *Economic Journal* (Vol. X), controverts this view, and although he refers to the language of his fellow experts as merely "infelicitous," and liable to deceive the "vulgar, who take words literally," it is impossible to avoid the conclusion that there is a real difference of opinion. "There is no objection," he says (p. 192), "to speaking of 'the portion which is a tax on ground rent', if we are careful to remember that this portion, and its proportion to gross rent has no relation whatever to the amount by which the ground rent tends to be reduced in consequence of the impost." And (p. 191) he says, substitute barley for house accommodation . . . "who ever heard, outside the pages of Adam Smith, of that part of a tax on barley which falls on rent?"

It looks an obvious criticism of this to reply, that, whereas rent does not enter into the price of barley, that price being the marginal cost of production, the rent of a building is the cost of production plus the ground rent. There is an apparent difference between the natures of urban ground rent and agricultural rent. Economists generally explain the latter as arising from the fact that fields differ in fertility, so that some doses of capital yield greater quantities of corn in one than in another.

There is also to some extent, difference of convenience in situation, but this can be taken into account by including cost of carriage amongst the expenses of production. In the case of urban rent, however, convenience of situation cannot be thus put into cost of production, and it is differences of convenience which are the chief cause of urban rent. There is not much difference between the cost of construction in different places in England. A city building could probably be duplicated in Brixton at about the same cost, or even less.

To explain urban ground rent as producers' surplus and to show the

identity of the nature of rent in the two cases, it must be remembered that what is really "produced" is a power to satisfy wants, a group of conveniences. In the case of buildings, mere size is only one consideration: vertical and horizontal position are as much attributes of the building which the purchaser considers as is cubical capacity. The builder in the city can produce greater "accommodation" in the wide sense, and he applies his capital until the marginal dose produces just enough net convenience to cover the cost. The total rent is the value of the net convenience produced, the price per unit of which is the marginal cost of production, and the rent is the value of the surplus quantity. The imagination cannot well picture a "unit of building convenience," other than as a certain cubical space, but this difficulty is not confined to urban land produce. The difference between two fields of wheat might be merely a difference in quality, not quantity, of corn, but to aid the imagination one takes quantity as constituting the difference, and corn or barley is taken as short for agricultural produce generally. For it is almost as difficult to think of a unit of agricultural produce as to think of a unit of urban produce in the wide sense; each is a certain quantum of utilities measurable in money value. The theory of rent is just the same in the two cases, and Professor Edgeworth is perfectly justified in appealing to the received theories of taxes on agricultural produce.

Very likely the dynamical analogy of the effect of the resultant of two forces or velocities, which can be found by treating each force or velocity independently and combining the result, may have suggested the division of the tax on rent into two independent portions. The method, however is quite fallacious. The existence of the tax on the building part of rent entirely destroys the peculiarity of the ground rent part, and the arguments by which a tax on ground rent is proved to fall entirely on the owner completely break down. Consider agriculture first. If a tax is levied only on economic rent the price of corn (meaning agricultural produce generally) cannot be raised, for the rise of price would bring into profitable cultivation a new grade of land, or cause a further dose of capital to be applied to land. This would mean an increase of supply, whilst with the higher price, the demand at best could not be greater than before. But if the produce of the new marginal dose were taxed equally with surplus produce, the price paid by consumers could rise to the extent of the tax before new doses of capital could be profitably applied. The tax is treated as levied from producers; if levied from consumers, we should say the price could remain as before without bringing fresh land into cultivation, so that in either case the consumer would have to pay the whole tax



unless he reduced his demand—hardly a genuine shifting of the burden.

It is the same with urban rates. A rate on ground rent alone could not be shifted on to consumers, because such shifting would mean an increase in the price of accommodation. A better money's worth could be got by building on land just outside the margin, or by pushing the margin of building higher (*i.e.* on the assumption that the different kinds of building convenience really do compete, and no doubt a number of people would prefer a larger house in a less convenient situation, or taller, rather than pay more for their existing accommodation). This could not last, for supply would be increased when demand could not possibly be greater. Owners would have to reduce rent. But if the new buildings on the margin had also to pay the rate, there would be no advantage in them. Apart from elasticity of demand, the price of accommodation could rise to the extent of the rate before the margin of building could be pushed higher or wider.

A tax on total building rent is like all other taxes on commodities, falling substantially on the consumer. He may reduce his consumption, and in that way indirect loss will be caused to producers for a time, and more permanently to owners of land required for the production of the commodity. But it is quite impossible to take such losses into consideration in practical politics, just as it is impracticable to take account of indirect gains. If the community, or a great part of them, alter their tastes, and spend more of their incomes, say on education, and have less to spare for house rent, those interested in real property must put up with it. If the unwilling are also compelled by law to make similar redistribution of their expenditure, the indirect effects are to some extent greater, but they are just as complicated and incalculable as if the change had been entirely voluntary. It is not meant that all discussion of incidence is futile; only that for practical purposes a tax levied in respect of any commodity must be regarded as falling upon consumers. If they shift any part by reducing their consumption they do not really escape the burden to the extent of their saving; they suffer loss of convenience. Every extra payment which does not work round so as to cause an increase of income has to be saved somehow out of saving and expenditure with indirect losses to the people concerned in the production of those commodities for which the demand is lowered. Income tax is all saved somehow, and the only difference between it and a tax levied on house rent is that in the latter case there is rather more inducement to effect the saving at the expense of house accommodation, since a reduction of house-rent means automatically a reduction of tax. But as house-rent and general expendi-

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ture are so closely connected, a house-rent tax is a much nearer approximation to an income tax than any other tax levied in respect of a particular commodity.

The more completely the question of incidence is examined, the more clearly is it seen how hopeless is the attempt to take account of anything but the loss to consumers. Professor Sidgwick points out that the beer tax is to some extent a tax on barley, and says that this should be taken into account in considering the burdens on agricultural land. Why should not the effects of government expenditure of the money also be considered? If the money goes to paying soldiers and sailors, very likely they spend as much on beer or other things that agriculturists help to produce as would have been spent on them if the money had remained at the disposal of individuals. It is still more difficult to say precisely what is the effect upon landowners generally of local rates for poor relief and education. A considerable part of the expenditure is expenditure on buildings. It may be conjectured that, even taking this into account, landowners tend to suffer rather more than they would if the tax had not been levied proportionately to house-rent. Nevertheless, it is quite useless for the practical politician to attempt to take notice of such loss; in the main it is merely the loss due to change in people's manner of spending their money, which must be borne by landowners as part of the ups and downs of fortune; the circumstance that rent is taken to measure people's ability to pay makes too little difference to be seriously considered. The question of appropriating for the state part of the increment of rent, on the ground that it is "unearned," must be considered quite apart from either incidental gains or incidental losses due to rates.

Further, it is rather an encouragement to erroneous ideas to suggest that part of rates should be directly levied from owners "for the sake of sentiment," or "to make the real and apparent incidences correspond." People grumble at rates for the same reason as they grumble at income tax, they are payments of substantial sums not immediately accompanied by a visible return. As a concession to the weakness of human nature it might be allowable to practise a little sleight of hand, as is done in imperial taxation by means of customs and excise: only if this is to be done it should not be pretended that any definite part of an onerous rate is *intended* to fall upon the landowner and leaseholder. Much less should rates be levied more highly on ground rent than on other rent for this reason. The fact that at present rates tend probably to the detriment of rent must not be allowed as a proof that they ought so to do. Specifically heavy onerous rates in any one district, if due to necessity, of course do naturally fall upon owners to something near the extent of the difference

between the rate in the district considered and the average of onerous rates. This is right, since the landowner's rent is caused by special advantages of one district over another, and, if a district is badly situated for drainage or anything of that kind, of course it is not to be expected that such good rents could be had there as elsewhere. To some extent also exceptionally heavy poor-rate should fall, as it does, on owners, because it is a sign that the economic conditions are abnormal. The landowner should normally get only surplus wealth, after the producers have been remunerated. An abnormal number of paupers, as in agricultural districts, may indicate that past history has led to a distribution of wealth not in accordance with that which would have prevailed if labourers had all along been really able to look after their own interests. Landowners may have succeeded in appropriating more than the true economic rent, and in that case they should in justice bear the burden of excessive poor-rate. In so far as the inequality of onerous taxation is not due to these causes, it is mischievous. No doubt readjustments of rent should in course of time equalise the burdens so far as general inhabitants are concerned, but this is done only by causing population to be distributed and capital applied in a way which is not the most advantageous for production. Such inequalities ought therefore to be abolished. Only those inequalities which are due to natural causes should be allowed to remain. It is only, then, in these cases that one can say that any definite part of an onerous rate ought to fall upon the landowner, and it is just in these cases that it does so fall. It is impossible to agree with the Royal Commission Minority that "it is also eminently desirable that the charge which now falls indirectly and irregularly on site value, should, if possible, be made more direct and visible, as well as more accurately and evenly proportioned." As to the advisability of making it more "direct and visible" that is primarily, as Professor Edgeworth says, a question in the art of politics, not a question of economic science. But the idea of making it "more accurately and evenly proportioned" implies wrong views. Any effect there may be, due to diminution of demand, is quite outside the business of government. Why should they not try to make the effect of the beer duty on landowners more accurately and evenly proportioned? And should not the effect upon owners of brickfields and stone quarries be included? Then there are effects on quasi-rents, less durable, perhaps, but often sharper while they do last, losses to bricklayers and builders, house decorators and furniture makers, domestic servants, etc. It is rather a curious argument to say that because rates have a tendency to cause indirect losses to all these people, they are therefore intended to bear part of the burden, and further, that that part should be made more visible and its existence more certain.

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Neither should this indirect effect upon rents be regarded as a set-off to indirect gains in other ways. If there were no such thing as an onerous rate the question of "unearned increment" would not be affected. Neither would it be affected if all rates were purely onerous, and every improvement which added cash value to property were undertaken by private enterprise.

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