IS A TAX ON SITE VALUES NEVER SHIFTED?[1]

It is held by most competent economists that, in general, a tax on land values cannot be shifted. There are, nevertheless, certain qualifications of this principle, some of which are generally familiar to economists and some of which are ordinarily overlooked. The following brief discussion of the problem is intended to indicate somewhat the importance of these qualifications and their relation to the main principle.

It is commonly admitted by economists that a tax on the value of "land" when the so-called land value includes fertility put in and to be put in by owners may be, in part, shifted. For such a tax may discourage owners from thus improving their land. They may prefer to invest their surplus labor—i.e., their labor above that used to provide for current consumption—in some other way. Hence, less acreage may be well fertilized, the supply of goods produced on agricultural land may be smaller, and the prices of such goods may therefore be somewhat higher. Here, however, we are really dealing with *capital*, "the produced means to further production,"[2] rather than with land in the economic sense. The tax, if it applies only to capital of this specific kind (fertility), will tend to make people construct, rather, capital of some other kind. Then the comparative scarcity of this kind of capital may be coincident with a comparative plenty of other kinds of capital. (And the products of such other kinds of capital may be increased in quantity and lowered in price.) But if the tax is applicable to all capital, then there will be no special discouragement of land improvement as compared with other kinds of investment. Whether or not such a tax will discourage saving, and hence capital formation in general, is another matter which need not be considered here. It seems clear, at any rate, that a tax levied upon the value of land exclusive of any value put into it by any owner's

[1] This paper is intended to consider almost exclusively problems of shifting and incidence. The writer has elsewhere discussed the social desirability of site-value taxation. See *The Taxation of Unearned Incomes*. The Missouri Book Co., Columbia, Missouri, 1921.

[2] Phrase used by Seager, "The Impatience Theory of Interest," *American Economic Review*, December, 1912, p. 846.

fertilization, drainage, or other improvement would not be likely to operate to prevent or discourage such improvement and so would not probably be shifted.[1]

But if a tax on land fertility is really a tax on capital value rather than on land value, may this also be true, in some cases, of a tax on the situation value of land? As an almost invariable rule, the situation value of a person's land is but slightly if at all dependent on his own efforts or investment but is a function of natural advantages and of the activities of those around him. An acre of land in Manhattan may be worth millions of dollars though no owner present or past has ever done anything to give it value; while the same amount of land in the Rocky Mountains or even in the center of the middle-western plains may be worth much less despite great efforts by one or more owners to give it value. One owner of land may try in every way conceivable, but without success, to make the situation value of his land great; while another, doing nothing at all, finds his land increasing in situation value because those about him, aided perhaps by natural conditions, make such improvements or develop such businesses that the locality where their activities are carried on comes to be a locality where people desire to locate for business or residence. If it should become obvious that, on a given city lot, a house could be built for $6,000 which would then sell, with the lot, for $10,000, the lot would at once be worth approximately $4,000

[1] The fact that a tax on fertility value can be sometimes shifted, in whole or in part, to consumers, is due to the dependence of such fertility upon the activity of the land owner. Hence, a distinction must be made between agriculture and mining. Fertility is maintained and restored by the effort and investment of the farmer. Ore is not restored by the mine owner. A tax on farm fertility does not at once raise the prices of farm products. It does this only when, in consequence of soil exhaustion, such products have become more scarce. Fertility rent may be a necessary inducement to efficient agriculture. But in the case of mines there is no point to providing an inducement to *restore* anything. It is true that a tax might hasten the exploitation of mines. But, unless it were so levied as to promote wasteful methods, it would not decrease the total amount of coal or ore mined. Higher prices might result in the future because of earlier mine exhaustion. But, if so, the more active present exploitation of the mines would mean *lower* prices in the present. If the prices of mine products are *lower* while the tax is on and higher when there is no tax because nothing is left to tax, we can hardly say that the tax is "shifted" to consumers. As a matter of fact, heavy taxation of mines need not at all interfere with conservation of mineral resources. If some mines were exploited more rapidly, this would tend to delay the exploitation of marginal mines. Furthermore, such taxation would tend to keep down the capitalized value of mines and to make their purchase by government easier, if special conservation measures seemed desirable.

without the house. The building of the house does not add to the situation value of the land as such. After the house is built, there is a greater real estate value by the value of the house, but the land, separately considered, is worth the same as before. If, however, several scores of persons build attractive homes in the immediate neighborhood of such a lot, it may come to have a higher situation value whether sold with or without a building upon it, than it would otherwise. Each such builder, while adding to his own real estate a value presumably about equivalent to the cost (including planning and supervision of construction) of his building, may add to the situation value of neighboring real estate by making the location more attractive to others than before. Thus the unforeseen tastes and the consequent building activities of some persons may increase the salable value of the land of other persons. In like manner, if certain business men choose a given block for retail stores, the habit so induced in the buying public of going to that locality to trade may give value as a store site to a lot not purchased or owned by the persons responsible for the new state of affairs.

It may, indeed, conceivably, sometimes happen that development of real estate owned by a score or more of separate persons, which none of them would find it worth while to begin independently on his own land, would seem worth while to a single owner of all the land, or to an association of owners, since the development of each lot might add something to what he or they—and not persons who had not participated—could get from neighboring lots. Thus, a large corporation may, in effect, found a city, and realize a gain from the resulting increase in the value of its land, as the United States Steel Corporation seems to have done, to a considerable extent, in the case of Gary, Indiana.[1] But if there were several persons or corporations able to finance such a comprehensive improvement and fully aware of the opportunity available, then the gain imputable to the improvement would be less. For the salable value of the land prior to the improvement would be more. For these various potential improvers would, each, be willing to offer more for the unimproved land, because of their ability profitably to improve it, than it would otherwise be worth or than it would bring if sold, thus unimproved, in small lots.

To forestall possible misunderstanding and objection, it may be well to explain the fact that buildings are sometimes constructed (e.g., in large cities) although the immediate yield on the total invest-

[1] See Haig, "The Unearned Increment in Gary," *Political Science Quarterly*, Vol. XXXII (March, 1917), pp. 80–94.

ment (land *and* building) is small, in anticipation of a rise in rental and capital value. As has been noted above, development through extensive building, etc., may sometimes be undertaken in the belief that site values as such will thus be increased. But if the increase of site values is expected to result rather from the general growth of the community—in the main, the usual condition—then such building will not be prevented either by a general tax on site values or by a tax on site value increments. Though the immediate yield on land and building together may seem small, the building is constructed because, and only because, it is believed that the net yield in excess of what would be received were it *not* constructed is as high as the general rate of return on investments of equal risk. Otherwise erection of the building would be *postponed*. Certainly an expected increase in site value due to the general growth of the community is no inducement to the early construction of a building since such site value could be realized by holding for later sale, without building. An owner who builds now because he does not wish to forego the *present* rental yield of his land is not building to get a future increment. And such an owner would be in *no less a hurry to build* in order to avoid a *present* land-value tax. Certainly a tax on community-made site value would not delay construction of a building since the tax payment to be made by the owner would be as great in case he did not build as in case he did. Indeed, it is to be noted that *the very reason immediate returns are low* in proportion to total capitalized value of land *and* building is because the prospective future high value of the land is capitalized into a high present value on which the current rate of return cannot at once be realized. If this future increase were to be taxed at a high rate and if the fact were generally known, the present value of the land would presumably be lower. Even with the tax, therefore, the percentage yield on present value would be no less.

The writer has frequently heard the argument advanced that a prospective increase in the value of their land is necessary to keep farmers in their business—that without this increment they would not get the current rate of return. (Is it equally necessary in every business? Without it would everyone leave his own business and go into another business where, also, he could not get it?) In truth, however, were land values taxed, or even were future increments taxed, the yield to farmers would be as large a percentage of what their land would then sell for—a larger percentage if we assume a corresponding reduction of other taxes—and they would be no less inclined to remain in the business, as against selling out (to someone who thereupon comes *into* the business?) or otherwise quitting, than before.

As a concrete case of improvement where the activities of land owners accomplish something toward the increase of situation value, let us suppose a group of men owning a considerable amount of undeveloped land remote from markets and railroad centers. We shall suppose, further, that potential traffic to and from this territory does not appear large enough to pay the ordinary rate of return on the cost of building a railroad into the territory (or perhaps, any return whatever) and, hence, that no one is willing to build such a road for the promise of earnings upon it. Let us assume the probable product of the land to be wheat. A railroad into the territory would be worth much more to persons cultivating immediately adjacent land than to persons farther from the railroad and the former persons could afford to pay higher rates than the latter. If rates for the transportation of the same kind of freight (in our example, wheat) could be made higher for shippers located near the railroad than for shippers who must bring their wheat longer distances by wagon or truck, then, we may suppose, the railroad could be made to pay. But such special rates to different shippers from the same service would be difficult to adjust even if they were not illegal. Hence, although the railroad may be worth building so far as the owners of the land, as a whole, in the given community are concerned, it may not be to the advantage of any other persons to build it and its building may have to wait upon investment by these owners in rough proportion to their anticipation of gain from it. In such cases, the building of a railroad by these owners corresponds, in a sense, to the fertilizing of his acres by a farmer or to the building of a store on his land by the owner of a city lot. It is an improvement on the land, the added value being, in large part, represented by the cost of the improvement. If there were a thoroughly competitive market for the sale of such a large land territory *as a whole*, then its value, *before the construction of the railroad*, would be approximately as great as after, except for the cost of construction. (We are here assuming that the railroad would just yield running expenses and could only be built because of the increased salable value of the adjacent real estate.) In a sense, therefore, the increased land value must really be regarded, in this case, as capital value, as being merely equivalent to the cost of the capital put *into* or *upon* it by the owners. Yet, in practice, probably if the land were under a single ownership and certainly if it were or came to be owned by different persons in separate tracts, these different tracts would be separately valued; and the values of most of them, though enhanced by the presence of the newly constructed railroad, would seem to be purely situation value—as indeed it really would be in the case of any such piece of land if neither the present nor a previous owner had contributed toward the building of the railroad. But to tax this value *when it is brought into existence through capital construction by the owners of the land so improved* may operate to prevent such capital construction and such a tax may be, in some degree, shifted.

On the other hand, the economic consequences of such construction may often be unfortunate, so that the discouragement of it, by land-value taxation, would do no harm. Thus, suppose one very large tract of land under a single ownership and control on which, therefore, any increased situation value due to the construction of, say, a railroad system, will be enjoyed by the same persons who have the railroad built; while in other parts of the country, land is separately owned in small tracts and no one person is in a position to reap the situation value which might result from similar railroad building. Under such circumstances population and industry might be largely drawn away from the territory held by many small owners into the territory controlled by one large owner; and they might be so drawn even though the latter territory had no natural advantages over the former and even though the former, if not thus denuded of population and business, would soon be able to support a railroad built without the inducement of a prospective situation-value increment. It is not an unreasonable hypothesis that the building of railroads subsidized by the United States government with enormous grants of land, thus uneconomically and prematurely developed the West at the expense of the development of the East; and this merely because of the greater concentration of ownership of large areas of western land, first in the hands of the federal government and later in the hands, also, of a few railroad companies.[1]

[1] The agricultural pioneer is said by some economists to have had a prospective "unearned increment" as an inducement to settle new territory. And it is quite possible that in the absence of such inducement, settlement in such territory would have been less rapid. Nevertheless, it by no means follows that the early application of heavy land-value taxation would, by retarding such settlement, have been shifted upon the general public. Would it have meant less wheat or corn? But undoubtedly some of those who took up western agricultural land in the pioneer days were already farmers and merely raised wheat and corn in the West *instead of* in the East. If they could not be induced to go West except by the prospect of

It is, of course, impossible to say what per cent of the apparent situation value of land is really, in the sense above indicated, capital value. Doubtless there are instances of contributions by landowners in various towns and cities to the building of electric street-railway lines, steam railroads, and other utilities (through purchases of stocks and bonds or otherwise), which contributions they would not be quite induced to make merely because of their expectation of a return on the utilities as such, from the rates charged, but which they are induced to make because of their hope of an incident increase in the value of their land. They are, as it were, by a common yet voluntary[1] action, improving their land out of savings; and a special tax upon the increased value so brought into existence might prevent their doing this, tend to diminish the supply of the kind of utility or other capital in question, and, perhaps, necessitate higher rates as an inducement to investors to construct such capital. Thus, in so far, such a tax would be shifted. It is likely, however, that in the case of a regulated

---

an increment in land values, can we conclude that their labor in the West was much more productive, that their going increased the volume of produce and that not to have given this encouragement would have made agricultural produce more scarce and its price higher?

Some of the western settlers, however, were persons not previously engaged in agriculture. If the offer of land and the prospect of a rise in the value of this land made them farmers, it would in so far increase the volume of wheat, corn, etc., and tend to lower their prices. *But it would simultaneously decrease the volume of whatever other goods or services these people were producing and raise the prices of such goods or services.* Who can say with certainty, therefore, that a tax on land values which removed the incentive to such settlement would necessarily have been shifted upon consumers of goods, in general, in the form of higher prices?

But would such a tax have been shifted upon wage earners in the form of lower wages? The prospect of enjoying a rise in value of land given to settlers by the government is said to have depleted the supply of hired labor and kept wages up. (Clark, *The Distribution of Wealth*, pp. 85–86.) This effect, however, was only temporary. Today wages may even be lower because of the policy formerly pursued, if, because of it, less land remains unappropriated. And it is not certain that a policy of land-value taxation would, even temporarily, have prevented the realization of high wages. For while it would have weakened the incentive to laborers to take up *government* land *far* from the centers of population, it would have discouraged speculation in *privately owned* land and so would have increased opportunities *near* the centers of population. What the net effect would have been we cannot, with certainty, determine. But the other taxes which land-value taxation might have displaced probably were shifted, in part, upon wage earners.

[1] Except as they may act in response to pressure from the local commercial clubs et al.

monopolistic utility the public would be asked to permit rates—if such rates could be charged and patronage kept—high enough to yield the usual rate of return on investment; and this even if the investors had enjoyed an incident increase in the value of their land.

In any case, it is probably true for the most part, as has been frequently and vigorously contended, that the situation value of any given piece of land is due to natural conditions, such as the proximity of bays and inlets, to the stage of the mechanic and other arts which makes one or another location preferable for various lines of productive activity, and to the activities and groupings of large numbers of people, and that what an individual owner decides to do or not to do is but an insignificant factor. The conclusion, therefore, that a tax on the situation value of land cannot be shifted, though it may require some qualification, is, in the main, hardly open to serious question.

HARRY GUNNISON BROWN

UNIVERSITY OF MISSOURI