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SOME ECONOMIC EFFECTS OF THE SPECIAL TAXATION OF LAND

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THE year just ended has witnessed the formal introduction of special land taxes in three of the cities of the United States. In Pueblo, Colorado, in Pittsburgh and in Scranton, Pennsylvania, the levies this year were made in such a fashion as to diminish the amount formerly charged to buildings and to increase the burden of land. It has also witnessed the abrupt termination of the informal Houston experiment and the defeat of the proposal to untax buildings in Denver. The Houston situation was more interesting than important. There, without bothering with the tiresome formality of an amendment to the constitution and a change in the statutes of the state which would have been necessary to make their action legal, the administrative officials proceeded on their own responsibility to declare in force a special land tax,¹ and advertised the system as an achievement. That the Houston experiment was possible at all is surprising and that it could continue undisturbed through four years is nothing short of amazing. Its discontinuance is of little significance, however, as a gauge of the drift of sentiment.

This movement toward special land taxes in the United States is new. Such taxes have existed in Canada for more than forty years and have experienced a truly remarkable development in the past decade. But the movement has until recently found no counterpart across the border. In Canada, it is true, the development is at a standstill at present. During the past twelve months practically no action has been taken

¹ Certain types of personal property were exempted and improvements were taxed at a low percentage of their value.

in the direction either of expanding or of contracting the application of the plan.¹ This constitutes practically all of the "news" of the movement since the last meeting of the association when the situation was so fully outlined in the papers of our Canadian friends.² On the whole the conviction that land is a particularly attractive subject of taxation seems to be gaining ground only slowly but nevertheless perceptibly.

Some truth and much nonsense has been written about the effects of the imposition of special taxes on land. Supporters of the measures developed a remarkable facility in imputing causal connections between the adoption of single-tax measures and manifestations of prosperity. Opponents of the single tax, in turn, have not failed to point to depression when it appeared as having been solely and directly occasioned by the radical tax legislation. Both sides are almost always wrong, for the exact truth is impossible of ascertainment. To measure accurately the economic effects of the imposition of a tax on land in any of the cities where it has thus far been adopted is a task in the field of economic analysis which is little short of appalling.

The good effects ascribed to the special taxation of land constitute a very long list. It is claimed that it stimulates building in a number of ways: by encouraging new and better buildings; by making difficult the retention of obsolete and unsightly buildings and of "fire traps"; by penalizing the man who refuses to improve his property and removing a penalty from a man who puts up a good building or who beautifies his

¹ There has been considerable discussion in some of the cities, particularly Edmonton, as to the possibility of continuing on a land tax basis during the present depression, augmented, as it is, by the European war. Cf. *Edmonton Journal*, June 18, 1915. "Single-Tax" Taylor was again elected mayor of Vancouver after a campaign in which the tax issue played a subordinate part. Acts providing for provincial taxes on wild lands and on timber holdings were passed by the Alberta legislature late in 1914. Statutes of Alberta, 1914, chapters 3 and 15.

² Cf. Single Tax Session of the Eighth Annual Conference held in Denver in 1914, pp. 405-469. The Committee on Taxation of the City of New York which was appointed primarily to consider the advisability of adopting a special land tax has not yet made its report.

structure. It decreases congestion and lowers rents. It discourages speculation and decreases unemployment. It penalizes the non-resident and the owner of vacant land. It encourages home-ownership and stimulates general economic prosperity. This list is by no means exhaustive. It comprises the replies usually received when one asks questions, in Canada for instance, as to why the system was adopted or why it is liked.

The opponents of the plan have an equally formidable list of reasons for their opposition. The scheme has little or no effect on building. Some say it discourages it. Others say that it is an undesirable stimulus; that it encourages the construction of sky-scrapers, instead of low buildings, of apartments instead of single houses, of "tax-payers" instead of substantial structures; and that it overstimulates all kinds of building and causes a depression. It increases congestion by making yards and gardens expensive luxuries. It has little or no effect upon rents, employment, home-ownership and speculation. It involves the confiscation of private property and serious dangers to the public revenues. Such statements as these in various proportions and degrees of vehemence are made to him who seeks knowledge from the opponents of the plan.

Of course the truth is that both are partly wrong and partly right. Examples of almost every effect mentioned can be cited in the Canadian municipalities. In some places the plan has brought fiscal disaster; in others it has had no unfavorable effects at all on revenues. In some places it has destroyed speculation; in others it has had no noticeable effect whatever in this direction. All of this merely shows that effects are matters of circumstance. The tax system is one of many factors in the situation. If certain factors happen to be present, the undesirable effects of the land tax will be neutralized and the desirable ones accentuated. If certain other factors are present the desirable effects may be neutralized and the land tax unite with other elements to form a compound of highly destructive power. The rate of increase in land values, the rate at which they are expected to increase, the rate of taxation made necessary by the change,

the suddenness and rapidity with which the change is made, the amount of vacant land, the amount of speculation, the amount of home ownership—these are some of the factors which tend to make or upset a situation.

The argument which is always mentioned by every person interviewed and the argument which after all is of greatest importance is that the form of special land tax which reduces the tax on buildings stimulates building activity. It is primarily through increased building that congestion is to be relieved, rents lowered, unemployment diminished, vacant lots eliminated, home-ownership encouraged and general economic prosperity stimulated. If the untaxing of buildings does not result in the stimulation of their construction, much of the argument of the defenders of the measure goes by the board. It may be worth while to analyze the building-stimulus argument in the light of economic theory. Such an exercise may make it easier for the members of this association to analyze their own local situations in order to determine what results may be expected there. At any rate it will serve to show how complicated this economic problem is.

In the first place, if I may be pardoned for adopting the approved war-correspondent style, I have been in western Canada and I believe that the untaxing of buildings there has stimulated building construction. I believe it not so much because of the statistics I gathered but primarily because so many people told me it had. The statistics do not make me believe otherwise. They are inconclusive. Economic theory leads one to expect that this result would come about if certain conditions were present and the people interviewed helped me to grasp to some extent what the conditions were in this case.

If depressions are psychological and we have it on high authority that they are, the same quality may be safely imputed to economic booms. They are certainly close relatives. If large numbers of persons were convinced in their own minds that certain circumstances which are present favor the construction of buildings and have the cash or credit to back their belief, there will be building activity—at least for a time. For immediate practical results there is nothing more important

than what every one expects the results to be. Certainly the Canadian west believes almost to a man in the building stimulus argument. "Does the single tax stimulate building?" was a question which, for the sake of retaining the respect of the person interviewed, it was found well to reserve until parting. Usually the answer was a look of startled surprise that such an obvious question should be asked. Yet is the question so obvious and is the answer the same everywhere?

We have been taught to believe that a tax on buildings tends to be shifted while the tax on land is not. If, therefore, a piece of real estate is leased or rented the question of incidence enters to complicate the situation. Classification is necessary to the intelligent discussion of this problem—cross classification in this case—for the capitalization of the tax on land enters as a factor also. In the first place there must be a division between those who build to use and those who build to rent. Then there must be drawn a second line of division crossing the first between those who own their plots already and those who do not.

Taking up these classes in order, those who build structures for their own use and who already own their land comprise the first. Let us take the concrete example of a man with a lot worth \$10,000 on which he desires to place a building worth \$10,000. What will be the effect upon this man's desire to build if buildings are exempted from taxation and the burden formerly carried by them transferred to the land? Since he uses the property himself there is no question of shifting here, and since he already owns the plot there is no question of buying himself free of the tax. Will the annual tax cost to this man be increased or decreased? Here becomes apparent the importance of some of the other factors. If every man in the town is in the same situation as this man, if every lot is being improved by a building bearing the same proportion in cost to the value of the plot, this man and every other man in the town will pay the same amount of taxes as before. If, however, (as is always the case), there is irregularity—if there are some lots with no improvements and some lots with an unusual amount of building value, the

taxes paid by this man will probably not be the same. In every municipality there is a "standard ratio" expressing the relationship between the assessed value of improvements¹ and the assessed value of land.² This ratio for Manhattan Island was, in 1914, improvements thirty-eight to land sixty-two. This means that any man whose building was assessed at more than thirty-eight per cent of the total value of the parcel would pay smaller taxes under the single tax and any man whose land was worth more than sixty-two per cent of the total value would pay greater taxes.³ Those with under-improved or vacant land would pay the taxes now borne by those who have improved their parcels well. The cities of the prairie provinces in Canada spread over vast areas, Edmonton, with a population of approximately seventy thousand has in area twice that of Manhattan Island. A sub-division is much more saleable to a non-resident if within the city limits and the city limits are manipulated to accommodate the real estate interests. The standard ratios are thereby lowered. The amount of vacant or under-improved land is seen, therefore, to be of some importance.

If the man in our illustration had been a Canadian, the chances are that his total taxes would have been decreased. Indeed the rate on the land alone has almost never been increased when buildings were untaxed.⁴ In this case the annual expense connected with being the owner and occupier of a house of this type would be lessened. It would be cheaper than before to own a house and more people might be expected to build. Hence more building activity.

¹ Together with any other portion of the tax base on which the burden is lightened.

² Together with any other portion of the tax base to which the burden is transferred from the improvement.

³ Since county expenses are localized, a separate ratio is necessary for each county of the city of which there are five. The standard ratio was calculated for the city at large and then a composite constructed, weighting the ratios according to the relative amounts of the city and county taxes levied in that county.

⁴ For details *cf.* Haig, *Exemption of Improvements from Taxation*, pp. 266-267.

But is it true that more people might be expected to build if buildings were cheaper? This statement assumes an "elasticity" in the demand for buildings—an expansion and contraction in the demand in response to a change in price. Houses or the upkeep of them may be cheaper than before. But will the amount saved be expended on houses or on something else? Will the part spent on houses be greater in a city of apartment dwellers than in a city of home-owners? Will the response to the change in price be more immediate and complete in a new and rapidly growing city than in an old and somewhat static one? To ask these questions is to suggest the more or less indefinite answers which must be given to them. But anyone familiar with the number of New York apartments without guestrooms and with lodgers will be inclined to believe that the demand for larger accommodations is a force which would be of considerable importance in the case of a lower cost. Moreover, in the case of rented quarters, there is a separation between the landlord and the tenant interests which makes for greater elasticity.

Still another point must be taken into account in considering the case of this hypothetical builder. Sometimes, perhaps most times, buildings are placed on land which is rising in value. In the City of New York this was so common that it became axiomatic that no depreciation fund need be laid aside to amortize the building, because the land value would increase at least enough to provide for the decrease in the value of the building. Buildings were rented and land values fixed on the assumption of this arrangement. Buildings were constructed long before a proper return could be secured upon the investment, because the increment in land values could be depended upon to make ends meet. The form in which this argument has been put in the past has been extremely crude; but there is little doubt that, operating indirectly, the "capital increment" has been a factor encouraging early building and low rents. Because of the necessity of paying charges such as annual taxes while waiting for the "capital increment" to "ripen" and because of the possibility of borrowing money to build on better terms than it was possible to secure it for the purpose of "carrying" vacant land, land owners have

sacrificed part of the future gain to save the remainder. In Vancouver, one man declared that the hope of making money out of the increased value of their plots was a more influential though less frequently mentioned cause of building activity than the exemption of improvements from taxation. It is probable that this factor is of some importance in western Canada but it is doubtless of greater importance in some of the older cities of the United States. In Canada the adoption of the special land taxes in the cities has not involved a tax rate great enough to affect seriously the expected increment. In New York a depreciation charge of two per cent on the cost of the building is recommended as proper. The tax rate is approximately the same figure. The rate of increase in land values has been very slight of late. If the untaxing of buildings would increase the tax rate to a point where the prospect for an increment was largely dissipated, what is gained in lower rents due to the decreased tax on buildings might be to a considerable degree lost in increased charges which will have to be levied to supply the depreciation account.

The lower tax bill which may fall to the lot of the man in the hypothetical case may be considered an attracting force. It is claimed that there is also a compelling force. If the base of the tax is entirely land, the full tax must be paid whether the land is improved or unimproved. Because of the difficulty in obtaining funds to carry vacant land, this would operate to encourage building.

The man who owns his plot and believes that his interests have not been affected because the taxes on his property remain substantially the same under the plan to untax buildings may awaken with a rude shock if he attempts to sell his land. Even though his taxes on land and building total less than under the old plan the selling value of his property will probably be less than before. This will be true in any case except that in which an owner's taxes under the new plan are less than his taxes on land alone under the old plan.

A number of the factors which have been discussed in connection with this first case of the man who builds for use on land which he already owns are of importance in the other three cases which must be mentioned. It will be seen

that the question of the stimulus to building in the case just discussed is not entirely obvious.

The case of the man who builds for his own use and who has not bought his plot beforehand can be disposed of quickly. If economic principles work out substantially without friction, he can buy his lot at a lower price because of the heavier tax on land. But on the other hand, his annual payment to the city because of his ownership of the land will be larger, by an amount which, capitalized, equals the reduction in the price of the land. Here again enter the questions of elasticity of demand and the effects of impaired increments upon the stimulus to build.

If a man builds to rent, he may gain an advantage in the way of increased business through the greater demand for accommodations at the lower price. But any decrease in the tax on buildings must, in theory, be passed along to the tenant in reduced rent. In practice, doubtless, the transfer to the tenant would not be complete and prompt. The gain to the builder must come either from the part of the tax reduction on buildings which for some reason he does not pass on to the tenant or from larger earnings from increased construction. The stimulus to build in the case of the builder who does not already own his plot is weaker than in the case of the land owner for, with the former, there are practically no incentives of weight while in the case of the latter the compelling force of increased taxes on land would be operative.

To summarize: if one wishes to know whether the untaxing of buildings will stimulate their construction, he must first find the answers to a series of questions. What is the standard ratio of building to land value? If it is greatly below that of a particular type of improvement, the construction of this type will tend to be stimulated. What is the practice of builders in anticipating the demand for houses? Are they built commonly before a proper return can be secured in rents? If so, the adoption of a plan which involves the impairment of the prospect for increased land values will discourage building. What is the magnitude of the changes involved? Will the tax rates be increased enough to affect seriously the increase in land values? Is the community one

of renters or of home-owners? Building might be expected to be more readily stimulated in a city of renters. Is the city growing rapidly or is it relatively static? If it is growing and values are rising rapidly, little need be feared in the way of weakened security to mortgage loans. There would be less likelihood of a shock to the faith of the community in the security of real-estate investments which would have an adverse effect upon building in general. What is the practice in financing real-estate loans? Is the margin of security narrow or wide? If wide, less danger of the reaction mentioned above will be incurred.

No pretense is made that the foregoing discussion is complete or exhaustive. It is merely hoped that the analysis may make more plain some of the complex factors involved and may thereby aid somewhat in coming to an understanding of the problem. It is evident from the experience of some of the cities of western Canada that buildings may be untaxed without disastrous consequences and with some distinct social advantages. The experience of other municipalities in the same region shows that the exemption of improvements is a dangerous instrument under some conditions. If imposed not too rapidly, where land values are increasing enormously, little difficulty will be experienced in the transition. If depended upon as the principal source of revenue in a region where values are highly speculative, unsatisfactory results are to be expected in a time of depression. The Canadian plan has some attractive points and it has some weak ones. It impresses the student as a somewhat bungling way to get the results desired, if indeed the desire to see the single tax established be excluded from consideration. Even if it be admitted that land should bear a greater part of the burden than it has borne in the past, the end can be accomplished by less awkward methods. To devise a method which will not outrage the feeling present in so many of us that investments already made should be safeguarded and which yet will secure for public uses a substantial share of the future undiscounted site value of the land of our country, is the task to which we must set our hands.