
Will West Germany Introduce Land-Value Taxation ?

Dr. MARTIN PFANNSCHMIDT

(Architect and former Government Surveyor)

At the ninth international conference I reported how the Government of the German Federal Republic had succeeded after 1949 in financing the German reconstruction from the returns of a fast growing production. On the following pages I shall examine how the reconstruction since 1955—the beginning of a boom that is still going on—developed under the tax and finance system in vogue, what attempts were made to fight the increasing lack of building land and its stiffening price, and what reasons have up to now prevented land-value taxation from being substituted for the real estate tax.

The housing problem is harder to solve in Germany than in most other countries. At the end of the war about a quarter of the 10 million dwellings lay in ruins. As well as the bombed out who needed to be housed there were 11 million refugees from beyond the Oder-Neisse and those continually streaming in from the Russian Zone. Between 1949 and 1958 about 4.7 million dwellings were built. A further 2.5 million will have to be erected by 1963—1.5 million to meet the still existing shortage, 1 million for the increase in households and for replacing old houses in decay. Seeing the impending balance between supply and demand the Federal Government are planning

to embody the housing industry into the free market economy.

The surprising achievement was brought about by the swift growth of production. The gross national product rose from DM 79.4 billion in 1949 to DM 222.3 billion in 1958. The purchasing power of the DM fell by about 12 per cent. Full employment was nearly reached.

In order to finance capital investment out of current production and current savings the Federal Government as well as the Laender had to promote increased productivity and re-investment by industry. Expenditure was kept to a minimum on opening up new building land and the resulting related services, including health and education, as they were considered less productive, and the building standards of dwellings were kept as low as possible. The result of this one-sided favouring of industrial production was an increasing concentration of big capital, big industry, and big towns whose unhealthy growth was essentially conditioned by the tax and finance system.

Investment rose from about 20 per cent of the gross national product in 1950 to about 24 per cent in 1958. In former times big industry used to finance investment by issuing shares and by its own economies. In 1956 its self-financing rose to 73 per cent. The consequence is that now 75 per cent of the existing shares are held within companies. This blocking of the share market and the diminishing interest in securities at fixed interest rates made private savings flow into the banks. Seeing the working capital concentrated in the hands of the anonymous big industry and big banks (see table, page 3) the Federal Government, after entering the second phase of the free market economy, endeavoured to form individual property by lowering the tax on small incomes and by spreading property in the shape of small shares (*Volksaktien*).

At present the buying of bonds of every kind is undertaken as follows:—

	Industrial Debentures	Shares	Public Loans	Municipal Bonds	Mortgages
Private	%	%	%	%	%
people	40	7	13	1	6
Banks	32	29	66	80	75
Public departments	2	23	8	15	15
Other enterprises	16	14	10	4	4
Foreigners...	10	27	3	—	—

The second reason for the concentration of industry is the turn-over tax that holds the first place in the German tax system. It yields about 28 per cent of the total revenue.

Unlike the "sales taxes" in the Anglo-Saxon countries the turn-over tax is not levied at the end of the deal but at every stage in production. Unlike the French turn-over tax that charges only the value added at each stage in production, it is imposed at every stage in production, on the total value including the taxes paid at the preceding stages. Industry naturally tries to escape from that accumulating tax by a vertical concentration of production and a horizontal concentration of sale. The Government see this drawback and so they have considered reforming the turn-over tax on French lines. But, as the tax is the chief source of revenue of the Federal Republic, nothing has yet been changed.

VERTICAL EXTENSION OF THE TOWNS

The tendency of industry to concentrate would be less harmful if it were not confined to the big industrial communities. The drawback is intensified by the municipal trade tax that has become the mainstay of the local government taxation and finance system. The big

industrial towns can offer more favourable locations with all services to manufacturers than can the small communities. They exploit their monopoly in order to raise their revenue from trade tax. They forget, however, to deduct from their profits the resulting expenditures for those engaged in industry. For the social costs that follow the increase of inhabitants rise faster than does the revenue from trade tax.

In contrast to the trade tax, the real estate tax has been petrified for decades by an artificially low valuation. Thus the municipal authorities lack the means of developing new building land outside the old residential districts. Instead of the erstwhile horizontal extension of the towns the phenomenon of a vertical extension took place. The increase of population—about 25 per cent—was mainly housed by adding storeys. The number of the storeys in the narrow centres of the towns is everywhere too great. Such districts are over-crowded. Moreover, compared to lower dwelling houses, the huge blocks are very expensive to build. These higher costs are offset by higher municipal or state subsidies at the expense of the taxpayer. In this way the municipalities avoid the expense of developing new areas. Seeing this unhealthy development the German town planners enviously look at Great Britain where even after 1945 the municipalities refrained from building huge dwelling blocks. In their New Towns they have erected representative models of new industrial towns.

The subsidised building companies in the course of the German reconstruction became the owners of numerous residential blocks. Thus those who live in them as tenants are denied a family home of their own, with a garden. This is due to the ownership of land, whether the owners are individuals or the municipality, and to the capital policy of the State that blocked the way. The average people have to be contented with the minimum accommodation.

In the towns it is becoming increasingly difficult for families and small enterprises to gain access to land and buildings. Traffic congestion, road accidents and public expenditure go on increasing. This unhealthy and quite unnecessary development is caused by the system of municipal taxation and finance. All too few, however, are aware of this.

TAX REFORM IS URGENT

The disproportion between trade tax and real estate tax is so great that a reform of the whole system is urgent. The Federal Republic and the Laender in this respect are waiting for the proposals of the local government associations that may be acceptable after discussions. The municipalities on the other hand cannot propose a reform so long as the State does not enable the smaller ones to attract industry to settle on their territory. From an economic point of view the big towns should be interested only in those industries which yield a tax revenue greater than the social costs they engender. All other industries would find much more economic sites outside the developed areas. But so long as their finances depend primarily on the trade tax, the towns do not see this.

The local authorities and their associations see their dilemma but they are not convinced that land-value taxation can help. They approach it very hesitantly. And the landowners fight it, be they landlords of the old type or subsidised building companies or the Trade Unions because they do not know its good effects on the economy. But a change is in sight. Prosperity always increases man's desires. People are no longer content with having a roof over their heads or with being motorized. Volksaktien was certainly a good beginning, but the much more general wish is a family home with a garden. Under the pressure of this desire the rigidity of the front lines is

beginning to slow down or to give way. This process may be seen in the following attempts of the lawgiver to produce a modern law of landownership and building.

DRAFTS OF LAWS

(1) The law for procuring building land (dated August 3, 1953) completely failed, as it lacked any regulations as to compensation in case of expropriation.

(2) The Federal Housing Minister has been preparing since 1950 several drafts of a Federal Building Law (in reality a town planning law), in which at first it was provided that the increase of land values in the towns should be valued, assessed, and levied by the towns as an increment duty. In the latest draft (dated April 16, 1958) the proposed increment duty gives way to a development charge that would reimburse the town only for expenses incurred in opening up land for building. Thus the proposed tax on increasing land values is cancelled. Valuation and assessment are to be done by public departments.

(3) This alteration facilitated co-ordination of the Federal Building Law with the draft of a law (dated June 21, 1956) which has been submitted to the Bundestag by the Federal Finance Minister. This draft relates to the taxation of property and provides for land and buildings to be separately valued, the first time since 1861. If it becomes law there are only supplementary regulations necessary about the organisation of the valuation of land. Then the land value taxation law—for which I submitted a draft in May, 1955—may be discussed.

(4) In order to break the increasing blocking of land on the outskirts of towns an advisory council of the Federal Housing Minister recommended that local authorities should impose a building land tax on vacant sites. The amount of the tax should be individually resolved in each case by the municipal government and raised progressively from year to year until the site was built upon.

Negative in this proposal is that the site tax should be levied generally and that—at least until draft 3 was in force—it should be laid on top of the petrified and unreformed real estate tax. Its better type—once carried through in Tsingtau and adopted by the Japanese there and in Manchuria—had been laid on top of a justly assessed land value taxation. Positive in this proposal is that the advisory council saw its only chance of influencing the land market in improving the real estate tax. Thus the advisory council may have helped to hasten reform of the real estate tax. Unfortunately they stopped half way, when they excluded my draft from discussion. They said that it meant a revolution in the tax system and that it extended far beyond their task.

EMBODYING THE HOUSING INDUSTRY INTO THE FREE MARKET ECONOMY

This shrinking away from land value taxation may have been caused by the determination of the Federal Finance Minister to concentrate first on two other laws,

- (a) to abolish rent control of dwellings—in force since 1917; and
- (b) to return subsidised building to private enterprise.

The first law is in full consideration and discussion. To make it acceptable the Housing Minister wants to make use of the institutions of the Welfare State to enable those with a low income to pay their rent. This may certainly be done. But it must not be forgotten that all the gifts of the Welfare State must come from taxes, *i.e.* they must be paid ultimately by the masses themselves. For all taxes—land value tax excepted—are shifted on to the consumer. And in the case of subsidies to tenants it is readily seen that they are to benefit not the recipients but the owners of land and of rented dwellings. This is why the average tenant may go on thinking that rent control should be kept though he may—when he is the lucky tenant of an old

dwelling—have a dim idea of how unnatural it is to pay less for his accommodation than the cost of its upkeep.

But when this law comes into force the housing industry will indeed be free from compulsion. Then the natural economic laws will come into force again. The price of land will increase and with it the rent of dwellings, if the concentration of industry and population goes on. No Welfare State can prevent this natural development. What then?

In this case the Welfare State can do only one of two things: either it can conform the rent-subsidies to the rising of land values or it can re-introduce rent control. However we look at the problem, the housing industry can be successfully embodied into the free market economy only if land value taxation takes the place of the old and inefficient real estate tax. This is a true reform. It will abolish the harmful tendency of industry to over-concentrate in the big towns, and no longer force those engaged in industry to live in skyscraper flats. It will give anybody who is industrious and thrifty and who so desires a chance to acquire property in land and buildings.