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LAND SPECULATION AND LAND-VALUE TAXATION

I. IS THERE SPECULATION IN LAND?

The advocates of greater taxation of bare-land values have often contended that speculation in land is a serious injury to the community. It causes economic waste, they say, by compelling the walking and riding of longer distances, past vacant lots, and by requiring a greater extent of water mains, gas and sewer pipes, telephone wires, etc. than would otherwise be necessary. It decreases productive efficiency, they contend, and so lowers wages by forcing the use of inferior land when better land would otherwise be available, and, through restricting the amount of land in use, by compelling a more intensive utilization of land than would otherwise be economical. Increased taxation of bare-land values, they maintain, would discourage speculative holding of land and would do so in rough proportion to the increase in the tax rate.

That there is some land held out of use by persons speculatively inclined everyone knows. Many of the speculators probably do not consider themselves such. They are willing to sell for a "reasonable" price. Some of them want only what the lots they own have "cost" them, including in cost the accumulated taxes and interest on the original price paid. (Since, at 5 per cent interest, compounded, a sum doubles in value approximately every fourteen years, a lot purchased for \$1,000 and held out of use for ninety-eight years should sell for approximately \$128,000, not allowing taxes, in order to repay to the owning family what the land has "cost" them. This might seem a bit hard on the person wanting to buy the land, and the income to the owning family might not seem to have been paid for by any equivalent service rendered. But all that is aside from our present point.)

There appears, however, to be some dissent, among professional economists, from the view that any considerable amount

of land is held out of use for speculative gains. This dissent seems to be based on the two assumptions that speculative holding of land is relatively unprofitable and that people will not do what does not pay. Professor Carver, although favoring land-value taxation, expresses his dissent on this particular point as follows:¹ "If an individual, Jones by name, has a tract of land which is not being used, there is no reason for believing that he would be averse to getting some income year by year while the land itself is rising in value on his hands. Thus he would get the rise of the value of the land just the same as though it were idle, and he would get, at the same time, whatever income it would bring him. There are not many men who deliberately prefer a smaller to a larger income."

Professor Carver, indeed, goes on to say that after land has been divided into building lots it cannot be cultivated economically; that "the public may be slow in buying the lots for building"; and that "for a number of years this land practically goes to waste." Nevertheless, the present writer, in view of considerations to be advanced in this paper, is inclined to believe that Professor Carver underemphasizes both the amount of land speculation and the significance of the human traits which produce it.

As a matter of fact, is the situation anything like so simple as this? All persons are not alike and do not equally find opportunity of gain in the same activity. Even if there are certain persons who would find it profitable to put houses or other buildings on certain lots—in case they owned the lots—it does not follow that those who do own the lots would find it profitable to do so. Still less does it follow that these actual owners would *know* such construction to be profitable. And their speculative anticipations and hopes may cause them to put a price on the lots too high to justify purchase of these lots by others who might see gain from improving them. Nor will it always be feasible for improvements to be made by tenants. Indeed, there must be a good deal of land worth using if improved, but not usable to advantage without the construction of buildings or the making of other

¹ *Principles of National Economy* (Boston: Ginn & Co., 1921), p. 737.

improvements, which buildings or other improvements tenants, unless they can arrange for long leases or other guaranties on terms not likely to be satisfactory to speculating owners desiring the privilege of sale without notice and free of incumbrances, will not care to construct or to make.

Let it not be supposed that we are assuming, for the discussion of land speculation and land improvement, any essentially different theories of human action than are properly to be assumed in the discussion of other economic problems. Thus, if a rise in the price of shoes makes the production of shoes in general more profitable than the production of steel rails, it will not, on that account, be more profitable for *all* steel-rail producers to begin making shoes instead of steel rails. Most of the steel-rail producers, employers and employees, are so relatively well adapted to steel-rail production and so relatively ill adapted to shoe production that for *them* shoe production would remain the less profitable business. So it is with land speculation as against building. Not all speculators would find building more profitable when and because some speculators would find it more profitable. It does not get us very far to say that if, *in general*, land improvement allows the improver to get both the "unearned increment" and something besides for the *use* of the land and the improvement, therefore *every* owner of land will improve his land as soon as advancing population brings a reasonable demand for the use of such land.

Many and large plots of land *are* held unimproved in the typical city for many years, while streets are built past them, while telephone and electric light wires are stretched over them, while gas and water and sewer pipes are laid beneath them, and while the expanding population builds homes for itself beyond them from the city's center. That the homes are built thus far out would seem to be evidence that there is a reasonable demand for these homes. The homes *are* built, indeed, but they are built where their building involves the comparative waste of greater distances for streets, electric wires, water pipes, and travel.

Nor is the evidence convincing that the holding of the intervening lots, *even apart from this incident economic waste*,

usually serves the purpose of avoiding the tearing down of houses for the erection of office buildings and the like, saving the vacant land for the latter purpose. Generally, when the intervening areas are first built up, they are built up in substantially the same way as the more outlying districts. Holding the land out of use serves, ordinarily, despite possible exceptional cases, no good social purpose. It merely forces the earlier use of the more distant sites and compels the economic waste associated with such use.²

The prospect of a rise in land values stimulates speculation in land by persons who become hopeful of gaining thereby. It causes the holding of land for prices higher than the current market conditions warrant, and so fairly good land may be held out of use while land of inferior location is substituted by those who wish to build. Of course, as a city grows, one after another of the owners of vacant lots decides to build or to sell. The process of building, in any area of a growing town, despite the retarding influence of land speculation, does usually proceed at a more rapid rate than the process of depreciation. For this reason—if for no other—the more centrally located areas of a town are usually built up (sometimes with buildings inadequate to the sites, but at least not absolutely vacant) by the time the town has grown to any considerable size.

Some of the owners who hold land speculatively, even if competent to direct construction and to make money from the improvements, prefer to use elsewhere their surplus funds, if they have any. Of course this may cause capital construction somewhere, but not on the speculatively held land. Others hold land idle for long periods from mere inertia or indecision. Still others, "land poor," have not the means—and perhaps not the credit—to improve, but keep all their holdings, hoping for a rise. And there are some owners of vacant land who prefer to invest any surplus funds they may have in purchasing more such land, hoping to gain a larger percentage on investment thus,

² See, further, the author's critical comments in *The Taxation of Unearned Incomes*, 3d ed. (Columbia, Missouri: Lucas Brothers, 1926), pp. 126–28.

through an anticipated rapid rise, than they could gain by investing such surplus funds in land improvement.

It may be said—it often is said—that, on the average, such large returns are not realized; that, indeed, land speculation usually does not pay. Perhaps, on the average, it does not. Neither, on the average, do lotteries pay. Nor does wagering money on a roulette wheel pay. All such gambling devices are purposely arranged so that the gamblers, on the average, pay in more than they take out. Else how could the proprietors reap any gain? But this does not prevent thousands—should we say millions?—of persons from participating in such gambling. Those economic theorists who picture the “economic man” as a person always choosing the most profitable line of action, and who then assume every man to be such an “economic man,” are singularly blind to the teachings of experience.

May not the case of land speculation be in some degree analogous? Even if only a minority of the population have the gambling instinct and would participate in land speculation (or in lotteries), that minority may be sufficient to lower somewhat the margin of production by holding good land out of use. It is not so much, perhaps, that speculation in land causes any great decrease in the total amount of land used, although one would expect, a priori, somewhat greater congestion because of such speculation. The more obvious effect, at any rate, would seem to be the forcing into use of poorer and more remote land instead of better and more accessible land.

II. IF THERE IS LAND SPECULATION, DOES LAND-VALUE TAXATION DISCOURAGE IT?

Some of the economists who contend that land-value taxation would not appreciably diminish land speculation, perhaps so contend because they think there is practically no speculation to discourage. It is this opinion which we have been critically examining in the preceding pages. Others, admitting the speculation, may believe that increased taxation of bare-land values, and, therefore, of vacant land, would do nothing to diminish it. Indeed, it is sometimes impossible to tell, from a writer's comments, which of these views he adheres to. Thus, Professor

Frank H. Knight, in a recent book review,³ refers disapprovingly to “the familiar single-tax heresy that taxes on land value would have any appreciable effect in the way of bringing additional land into use.” No criticism is here intended of Professor Knight for failure, in a brief book review, where complete elucidation of his own opinions could not be expected, to make these opinions perfectly clear. What is desired is to make the reader see with entire clearness that there are these two possible explanations of the dissent of various economists from what Professor Knight calls “the familiar single-tax heresy,” and that the two views must, for the purpose of critical analysis, be sharply distinguished.

Professor H. J. Davenport seems to have taken the position that there is speculation in land, but that land-value taxation, unless 100 per cent of the rent were to be taken, could not be expected to decrease it.⁴ Indeed, he even goes so far as to argue that such taxation (less than 100 per cent) would actually increase speculation in land. After intimating that relatively little agricultural land of high grade is kept entirely uncultivated because of speculation⁵ Professor Davenport goes on to say:

More serious are the speculative aspects of land-holding and land-improving in urban centers. So far, clearly, as the outlook for increased earning power and higher prices tempts a particular class of operators to invest, a class of men with neither the disposition nor the resources for improvement, some land must be retarded in its improvement—those operators who intend a mere gain in price as a return upon investment outbidding the competing offers of the long-run investor. To remove the inducements to speculative purchase by canceling all prospect of the private enjoyment of whatever rent or increases of rent shall attach to the land is obviously to exclude this speculative demand.

But even the more clear is it that to fix a tax, whether present or prospective, at anything short of the entire earning power—to leave a shell of individual property and income—is merely to make the gains still greater in proportion to the investment necessary to control them and is to foster the greater speculative activity that goes with operations on margins.⁶

³ In *National Municipal Review*, June, 1925.

⁴ See, however, later suggested interpretation of his statement.

⁵ That it is improved and cultivated as it might be does not follow.

⁶ *American Economic Review*, March, 1917, p. 16.

No criticism is here advanced against the first of the preceding two paragraphs or against the larger part of Professor Davenport's paper. In the view of the present writer, Professor Davenport has carefully analyzed and brilliantly refuted a number of arguments currently directed against greater land-value taxation. And the case for such increased taxation of land values is, indeed, sufficiently strong even if no decrease of speculation could be hoped for because of it. But he is mistaken, the present writer is convinced, if he does not admit the discouraging effect of any considerable increase of land-value taxation, applying equally to used and to vacant land, on land speculation—granting that there is any such thing as speculation in land, and Professor Davenport is not among those who deny its existence. In other words, our criticism—so far as there may be criticism—is leveled against the second of the two paragraphs quoted. It would seem, however, that Professor Davenport must have had in mind, not a general tax on all land value, but only a tax on the rent of used land, vacant and unused land being left untaxed. In such a case, while the tax would hardly encourage speculation, it clearly would not discourage it, unless, as Professor Davenport says, 100 per cent were to be taken, and unless possible speculators expected this. But if the tax applied as well to vacant land, then, as Professor Davenport would probably agree, it could not but be a discouragement to land speculation.

Let us attend, carefully, to the arithmetic of the problem. Suppose a piece of land having an estimated net rental value of \$50 a year and a salable value, on a 5 per cent basis, of \$1,000. A speculator anticipates a rise in its value and buys it to hold for such a rise. He has no training for utilizing the land and intends only to sell again when the time seems ripe. There is no tax on the land. It happens to rise in value at about the rate of 5 per cent a year, compound interest, so that at the end of fourteen years it is worth about \$2,000.⁷ At that time the speculator sells. He hoped for an earlier rise, perhaps, and did not intend to hold

⁷ Throughout the rest of this article, for simplicity of exposition by the avoidance of fractions, it will be assumed that 5 per cent compound interest means doubling in value in fourteen years. This is not exactly true. A little longer is required.

on so long, but he congratulates himself that he has secured at least 5 per cent on his investment. Perhaps he is lucky. If a value of about \$2,000 for this land at the end of fourteen years had been generally foreseen persons who could use the land profitably during the interim would have been able to offer more than \$1,000 at the beginning and would so have been in a position to outbid the speculators. On the other hand, if the speculator wrongly anticipates a rise to \$2,000 in a year or two, and users do not share his anticipations, he will outbid them. At any rate, in our example, he has made about 5 per cent, compounded, on his original investment. But, it may be said, he would have made more than that had he used the land, since he would have received the income from its use as well as the rise in its value. Such use, however, would have required further investment. In the first place, he may lack the necessary experience and ability to follow such a course. In the second place, he may be unduly optimistic regarding the prospect of a rise in the value of the land, and may so anticipate a larger percentage of return from using all his funds in speculation than from using a part of them in construction.

But our concern here is with the question whether taxation of land would make any difference. Granting that land speculators are, on the average, of the unduly optimistic, gambling, lottery-loving type, does taxation of land values put on them any penalty of such a sort that they are less likely to speculate with such taxation than without it? In the case we have assumed, there being no tax, the speculator gains about 5 per cent, compounded. He might, to be sure, have gained more by improving the land, but we have seen why an optimistic person with a lottery-loving type of mind—as well as some speculative holders of a different type—might be unlikely to invest in improvements. How would the case stand, now, if the tax rate were high enough to take half of the potential rent, or \$25 a year, going up to \$50 a year at the end of the fourteen-year period when the land had doubled in value?⁸ In that case, the value of the land would be,

⁸ As was pointed out in a previous note, it is not quite true that 5 per cent compound interest means doubling in fourteen years. The period required is a little longer.

presumably, only half as great at every point of time. It would be \$500 at the beginning of the fourteen-year period, instead of \$1,000. It would be \$1,000 at the end of the fourteen years, instead of \$2,000. Does the speculator gain a larger percentage than before, or even as large a percentage? His land rises from a value of \$500 to a value of \$1,000, instead of from \$1,000 to \$2,000. But he now has to pay an annual tax of \$25 a year, coming up to \$50 at the end of the period. His net percentage gain is certainly smaller.

If the speculator wants to invest as great a sum at the beginning as if there were no tax, viz., \$1,000, he will have to buy twice as much land. If this land rises from \$1,000 to \$2,000 in value during fourteen years,⁹ he will have gained 5 per cent, compounded, minus the annual tax which begins (on this larger piece of land having a rental yield of \$100) at \$50 and works up to \$100 at the end of the fourteen years. Is it not clear that the gains from land speculation are seriously reduced by such a tax? The speculating owner certainly doesn't come anywhere near making 5 per cent!

But there may have to be faced, in the minds of some economists, another objection. Granting that the returns from land speculation are reduced by such a tax, they may say, will not the returns from land utilization be reduced in equal degree? Most assuredly not. The returns from such utilization are as large a percentage as before. The land yields as large a net percentage of rent on its value, for, the tax being capitalized, the land can be purchased for a correspondingly lower price. (Indeed, since the price of the land may have depended not solely upon the bidding of would-be users, but partly upon the bidding of speculators, and since this bidding tends to be discouraged by the tax in question, the price of the land may conceivably fall by a greater percentage than the net potential rent.)¹⁰ And the yield of the improvements is certainly no less.

⁹ A little over fourteen years, but nearer fourteen than fifteen.

¹⁰ In so far as the value of land is determined by users rather than speculators, a tax which reduces the net rent of land tends to reduce its salable value in the same, but in no greater, proportion.

Let us suppose, now, a higher tax, taking nine-tenths of the potential rent. This will leave \$5 net potential rent on the lot, instead of \$50, and should make its salable value one-tenth as large, or \$100.¹¹ If the speculator now buys it, and if it doubles in value in fourteen years, as before, it will then be worth \$200 (the capitalized value of \$10 a year net rent, i.e., of \$100 minus a tax of \$90). The speculator can be said to gain \$100, or 5 per cent compounded, only if no consideration is given to his outgo of \$45 a year, gradually increasing toward \$90. Even if the rise of rental value takes place suddenly at the end of the last year, so that the tax is a flat \$45 a year for the entire fourteen years, still the speculator has had to suffer an outgo of \$630 ($\45×15) during fourteen years in order that he may sell for \$200 at the end of that time the lot he bought for \$100 at the beginning.

Or suppose he wants to invest as much in land as the given lot would sell for if untaxed, viz., \$1,000. Then he would buy ten such lots. If, at the end of fourteen years,¹² the ten lots have doubled in value and can be sold for \$2,000, the speculator cannot consider that he has made \$1,000, or 5 per cent compounded, *unless he refuses to reckon, as offsetting this gain, the annual tax*. This annual tax on the ten lots, assuming no rise in value until the end of the period, is \$450, amounting, during the fourteen years, to \$6,300. Clearly, such a speculator would not fail to gain, but would suffer, relatively to his original investment, a tremendous loss.

Yet a person who wished to buy the \$1,000 worth of land at the beginning of the period for improvement and use would be able to make just as large a return upon the land, as such, as if there were no tax. For the diminished rental yield would be as large a percentage as before of the lower capitalized price. And the return on the improvements put upon the land would not be reduced. Indeed, if the heavier tax on land values should

¹¹ See, however, foregoing remarks regarding possible effects of discouraging speculation.

¹² Fourteen years, plus.

make possible a reduction of the tax on capital, the net percentage of return on the improvements might be greater.¹⁸

If, then, \$1,000 invested in land will yield as large a return in future rents when land values are heavily taxed as when they are not taxed at all, provided the land is improved and used, and if \$1,000 invested in land held vacant and unused, which happens to double in value in fourteen years, will yield some 5 per cent, compounded, if there is no tax, but will cause a net loss of \$5,300 (\$1,000—\$6,300) if there is a tax of 90 per cent, shall we say that the advantages of use and speculative holding are in the same relation to each other whether there is a tax of zero or one of 90 per cent? Yes, if the tax is only on rent actually received. No, if it is on potential rent and applies equally to unused, partially used, and fully used land.

But perhaps some one will still say that, even if the land is not taxed, the speculator will really suffer as great a loss through speculating as if it is heavily taxed, the difference being merely that, in the former case, he fails to secure a gain which he might get by using the land, while in the latter case he suffers an outgo in the form of an annual tax.

Let us compare the two cases and see if there is really no difference. With no tax, assuming the land to double in value in fourteen years, an investment of \$1,000 in land not used nets 5 per cent. But it might, if the land were used, net, in addition, \$50 a year. (We shall here assume, for simplicity of exposition, that the rent does not rise above this annual sum for fourteen years, when it suddenly becomes \$100; but our proposition would be equally demonstrable in any case.) There is, then, a loss of \$700 rent in the sense that the speculator might have had this rent in addition to his increment. With a tax of 90 per cent, his loss in net rent (what he might then have by using the land) is \$5 a year, or \$70, and his outgo for taxes is \$45 a year, or \$630, making \$700, as before; but his gain from rising value

¹⁸ The larger net return on capital, unless and until increased saving reduced the rate of return at the margin, would involve capitalizing *land* at a higher interest rate, so that the net rent of *land* would be a *higher* percentage of its salable value than if there were no tax on the land.

is only \$100 (\$100 to \$200). Or, if he buys a piece of land ten times as large, so investing an equal sum, \$1,000, at the start, then his loss of net rent from holding the land idle is \$50 a year, or \$700, and his outgo in taxes, \$450 a year, or \$6,300, making a total of \$7,000 as against a rise in value of \$1,000.

III. SUMMARY AND CONCLUSION

The percentage of increase in the originally invested sums may be as great—if the land rises in value as the speculator hopes—whether there is a tax or not; but the annual penalty is much greater in proportion as there is a heavy tax. It is as if a person who risked \$1,000 in a lottery, on the roulette wheel, or in some other gambling venture had to pay a tremendous sum in taxes for the privilege of engaging in the lottery or other venture, a sum which would probably more than equal his gains even if there should be gains. Would not such a tax diminish land speculation? Shall we say that it does not diminish land speculation because there isn't much of any, on the theory that it doesn't pay on the average and that people won't do what doesn't offer probabilities of paying? Shall we say that a tremendously heavy tax on persons participating in lotteries and other gambling in proportion to the amount of their participation, so that they could hardly gain under any circumstances, would not diminish gambling because there wouldn't be much anyhow, since, on the average, gambling does not pay, and since people don't do things that do not pay? In truth, gamblers differ. A low tax would discourage some of them. But a sufficiently high tax, if it could not be evaded, would discourage nearly all of them.

There is nothing in the nature of men as we know them to justify an a priori conclusion that no appreciable speculation in land ever takes place. On the contrary there is, a priori, every reason for expecting a considerable amount of such speculation. For we know that many persons will "take a chance" at ventures when the average result to participants must be loss.

Will those who are trying to show that there is no such speculation of importance fare better by examining the "actual

facts"? It would be necessary to show that practically no land, except marginal land, is so held out of use; that land appreciably more isolated, or requiring more travel back and forth, or otherwise poorer, is not resorted to because of such speculation, and that rent is not increased because of it.

At any rate, if there is any such speculation at all worth mentioning it must be admitted that heavy land-value taxation, resting equally on land whether used or unused, must discourage it. Should it be established that there is not enough speculative holding of land to do any significant amount of harm—and it seems unlikely that such a conclusion can be established—then those who believe that heavier land-value taxation is desirable must thereafter confine their attention to the other advantages of such taxation. The present writer has been in the habit of putting emphasis rather upon such other possible advantages; but he is nevertheless strongly inclined to suspect, despite the depreciating comments of Professor Knight and others, that the discouragement of holding land idle and of thereby lowering the margin of production might be a real, even though a relatively minor, advantage of such taxation. As long as the unused land is better than the marginal land, its use by the owners, or by persons to whom they may lease it, or by persons to whom they may sell it, tends to increase production. And this is not only true when the owner is compelled to sell without securing an increment in price over what he paid. It is equally true if he must sell for a price less than he paid. Holding land out of use to avoid selling for a low price has the same kind of effect on production as holding it out of use in the hope of selling for a high price.

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