

CHAPTER II  
TAX "RELIEF" FOR REAL ESTATE

§1

*Taxing Intangibles to Relieve Real Estate and  
Other Tangible Wealth*

Recent decades have witnessed, at any rate in the United States, a considerable demand that the burden of taxation be removed in part from real estate and be placed elsewhere. Should or should not this demand of real estate owners and dealers be taken seriously? Before answering this question, we may profitably inquire regarding the availability and the desirability, as substitutes for real estate taxation, of certain other taxes commonly levied or commonly urged?

Let us consider, first, taxes on so-called "intangibles," viz., stocks, bonds, mortgages, savings accounts, etc. There is a contemporary tendency, already expressed in the statutes of some of our states, to remove these intangibles from the tax list or, at any rate, to levy upon them only a nominal tax. The chief argument advanced for this policy seems to be that the tax on intangibles is regularly evaded, that stocks, bonds and mortgages can be concealed and

usually are concealed, and that assessors are helpless to prevent concealment.

Yet there are still some persons who are insistent that the attempt to tax intangibles should be made and who propose more or less drastic means of securing better assessment of them. And proposals to cease taxing such property still meet with widespread popular opposition based on the belief that not to tax it must involve placing heavier burdens on home owners and farmers. The popular idea, in jurisdictions where intangibles are still, according to the theory of the law, taxed, appears to be that stocks, bonds, mortgages and deposits in banks constitute property which *ought* to be taxed and which, if taxes on intangibles were formally abolished, would entirely escape taxation.

There is an interesting, though confusing, passage in which Professor Edwin R. A. Seligman of Columbia University seems to countenance this view.<sup>1</sup> In it he remarks that the general property tax is relatively burdensome on farmers *because* their property lies in the open and cannot be concealed while the contrary is the case with personalty owned in the cities. "Outside of the rural districts," says Professor Seligman, "the

<sup>1</sup>*The Shifting and Incidence of Taxation*, fifth edition, New York (Columbia University Press), 1926, p. 255.

great mass of personal property consists of intangible personalty which, as a rule, escapes taxation almost completely. In the rural districts, on the other hand, the great mass of personalty consists of visible tangible property used by the agricultural communities. The country landowner, who is generally assessed also on his visible personalty, must thus pay, *over and above his just proportion*<sup>2</sup> of the public dues, an additional share which ought to have been assumed by the owners of intangible personalty."

This notion, largely, one suspects, because of the deference paid to Professor Seligman's views by many economists, has been widely accepted in academic circles. Thus, we have the little book of *Questions and Problems in Economics* by Professors George D. Haskell and R. Emmett Taylor,<sup>3</sup> in which there occurs the following passage:<sup>4</sup>

"The city dweller has a large part of his taxable property in the form of intangible

<sup>2</sup>Italics are mine. It is indeed curious that Professor Seligman can make such a statement when he himself elsewhere (*Essays in Taxation*, 9th ed., New York—Macmillan—1921, p. 100) recognizes that the taxation of intangibles is usually double taxation!

<sup>3</sup>Revised edition, New York (Macmillan), 1930.

<sup>4</sup>Page 80. And yet, *mirabile dictu*, only two pages farther on, these same writers (again following Seligman?) are saying that taxes on stocks and bonds involve *double taxation*.

property, whereas the rural man has his wealth in land, buildings, equipment and livestock. Show that these facts tend to result in the general ✓ property tax *discriminating*<sup>6</sup> against the rural population and in favor of the urban population.”

Yet this view (except in so far as the intangibles held represent claims to monopoly or quasi-monopoly returns) is *utter arithmetic nonsense*. The legitimate conclusion is simply that the city man who owns securities evades ✓ *double* taxation. He merely avoids paying a *second* tax on property which has already been taxed.

Consider the facts. If a man owns a \$40,000 farm it is assessed and taxed once. If several own it in partnership, the same is true. The case is similar with a store or factory. But suppose the owners, as is likely to be the case with the store or the factory but seldom with the farm, change their business from the partnership form to the corporation form. The same persons still have ownership and the total value of what they own is the same as before. They possess a \$40,000 store or factory. But, by a legal fiction, the store or factory is now said to be owned by an entity ✓ or fictitious person called a corporation, while the former partners now own stock, or stock and

<sup>6</sup>Italics are mine.

bonds, of the corporation. One would suppose that to tax the \$40,000 store or factory would be enough. But when stock and bonds are reckoned as separate items of property subject to taxation, there are two taxes on this \$40,000 instead of one. The physical plant, including land, building, machinery, goods on hand, etc., is taxed as belonging to the corporation. Then the owners of the stock and bonds are taxed again on the paper evidences of their ownership, or would be if the tax on intangibles were not so generally evaded.

It is as if a farmer were taxed once on his farm and a second time on his *ownership* of the farm. If the owner of stocks and bonds evades this second tax while the farmer nevertheless is taxed on his horses, cattle and machinery (just as the manufacturer is taxed on his machinery, raw materials and finished goods), certainly this does *not* mean that the farmer is paying "over and above his just proportion of the public dues, an additional share which ought to have been assumed by the owners of intangible personality."<sup>6</sup>

But our general topic is "tax relief for real estate." Surely, therefore, we must note especially the opinions of those whose reason for

<sup>6</sup>Unless Professor Seligman means to imply that what the letter of the law requires is *ipso facto* just.

wanting intangibles taxed is that they desire to "relieve" real estate. In a purely formal sense such taxation does relieve real estate. Does it in any other sense? It is true that, in raising a given amount of revenue, *some* owners of real estate may be taxed less if owners of intangibles are successfully required to bear a part of the burden. But *other* owners of real estate are, in that case, taxed more. For there is, in their case, a second tax on the same basis of material property.

In passing, we may well point out that *the same sort of discrimination is practiced whenever a corporation franchise tax or a capital stock tax is levied which is in addition to the tax that would be levied if the owners held their property as individuals or in partnership instead of through a corporation. The tax is made higher just because of a difference in the legal form of ownership, although the total property may be no greater and may even be less and although the real owners of the property may be no better able, or may be even less able, to pay.*

Taxes on corporations, corporation franchises, etc., seem to be fairly popular, probably because the ordinary citizen is not conscious that he pays them. And they sometimes receive respectful consideration from economists who write text books on public finance! Yet they are not to be

commended as ways of raising revenue. Either ✓  
the corporation is a desirable form of business organization or it is not. If it is not, then, indeed, there might be justification for prohibitive corporation taxes in order that corporations should be eliminated. But if corporations are desirable, then there is no argument for subjecting them, and, through them, the owners of their securities, to special discrimination. Even if a corporation is in receipt of an excessive monopoly income, and the market value of its stock is, therefore, in part, a capitalization of this income, prevention of monopoly or public regulation of its charges is to be preferred either to special taxes on it or to taxes on all securities.

But, it may be said, at least we should tax mortgages, money loaned on other security, and bank accounts. Let us consider, as typical of all these cases, the case of a mortgage. X has a farm, worth \$25,000. But Y holds a mortgage on it of \$20,000. Would it not be the sensible thing to say that there is a total value, the farm, of \$25,000, that Y has a first claim on this value, of \$20,000, and that X has a claim (sometimes called an equity) on the remaining value, which comes to \$5,000.? The existence of the mortgage merely means that a part of the income goes to Y and that, in event of a sale being necessary when the mortgage falls due, \$20,000 of the price

received goes to Y. The existence of the mortgage does *not* mean that there is a total value of \$25,000 *plus* \$20,000. Does any reader, then, seriously contend that because there is a mortgage on the farm, therefore a tax should be levied on \$45,000 instead of on only \$25,000? Is the farm worth any more or capable of yielding any more because X owes Y part of it's value? Doesn't a tax on the mortgage, when the total value of the farm, as such, is already taxed, mean *double* taxation on four-fifths of the property?

Yet such double taxation is attempted—though, largely, evaded—in Missouri and in other states where the so-called general property tax is on the statute books. And any proposed abolition of the system continues to meet large popular opposition!

To suggestions that only the tangible property be taxed, without regard to any mortgage upon it, the objection is sometimes made that this would leave the holder of the mortgage without taxation. But such a conclusion is scarcely justified. For a general tax on all capital reduces the net income which the property yields to its titular owner. And this necessarily *reduces the interest which he can pay to the person from whom he borrows*. The lender is really taxed if, because of the tax levied, he has to accept less interest.



Thus, if a farmer, by investing \$10,000 in draining a swamp, can add to his annual returns \$700, he may be able to pay approximately 7 per cent interest on the \$10,000 which he needs for the purpose. But if the additional value of his farm, due to his draining of the swamp, is to be taxed 2 per cent or \$200 a year, he must either secure the loan for not over 5 per cent or he cannot afford to borrow at all and cannot make the improvement. The lender can receive only 5 per cent and not 7. And the loss falls on the ultimate lender no matter how far he may be removed from the borrower. Thus, if the ultimate lender is a policy holder in a life insurance company which invests largely in mortgages, this policy holder—and all other policy holders—is affected through higher premiums (or lower dividends) by such taxes. And so with the person who puts into a savings bank a few dollars which the bank invests in mortgage bonds, i. e., which it lends. Shall we say then, that the lender is not taxed? Shall we say that, in order to tax him, we must tax the \$10,000 additional value of the farm, resulting from the drainage system, *and also* the \$10,000 claim of the lender on this value? Shall we thus try to tax the same value twice?'

'It should be obvious that the same principle applies in the case of a commercial bank deposit. The holder of a deposit has a claim on the

If evasion could be entirely prevented, as experience shows it can not, then the parties concerned would have to expect the following results:

1. The \$10,000, if invested, would yield, as before, \$700 a year.
2. The additional tax on the farm, \$200, would reduce this to \$500.
3. Not over \$500 as a maximum, or 5 per cent, could be paid by the borrower to the lender.
4. Of this \$500, another \$200 would be taken from the lender as tax, leaving him not over \$300.
5. But since the lender could avoid this *second* tax by using the funds himself, directly, instead of lending, e. g., by improving a farm of his own which he might thereafter lease for (say) \$650 additional per year to a tenant (or use it himself more profitably than before), he would very likely *refuse to lend at a lower interest than 6½ per cent.* The tax of \$200 would then leave him \$450 net interest.

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bank, which claim is backed up by the bank's claims on those to whom it has made loans. To tax the material property of the borrowers from the bank *and also* the bank deposits which are really supported by this property, is double taxation.

6. If the lender won't take less than 6½ per cent and the borrower can't pay over 5 per cent, *the loan and the improvement of the borrower's farm cannot occur.* They can occur only in those cases where the borrower's prospective increased output from the improvement is *very greatly* in excess of what the lender could otherwise make from his savings. Thus such taxation tends, often, to keep capital from getting into the hands of the persons who could use it most productively.

How foolish our people in those states where this is still the policy, to attempt taxing both the physical wealth *and* the loan secured by that wealth! How preposterous the reasonings of those among our economists who, seeing such laws evaded, still talk about the burden "which *ought*<sup>s</sup> to have been assumed by the owners of intangible personalty" and who talk glibly of the desirability of "reaching" the owners of such property! How hopelessly uncomprehending are those who contend that reliance for public funds on taxation of tangible property is no longer fair ✓ or practicable *because* there is now so much more of intangible property than in our early history! How far are Seligman and other academic

<sup>s</sup>Italics are mine.

economists who write on taxation, responsible for the nonsense now spreading among professional "educators" and others seeking funds for public schools and state colleges, to the effect that our modern corporate organization of business necessitates new types of taxation *in order that* these "tremendous values in new types of property" may not "escape"!

It may be of interest to the reader to notice the lengths to which this notion regarding the "escape" of intangibles can be carried by "practical" men of affairs. In 1929 the Governor of Missouri, on the authorization of the legislature, appointed a Survey Commission to investigate the fiscal needs of the state, considering hospitals, prisons, schools, etc., and the possibility of securing the revenue to provide for these needs. The Commission, after intensive study, made its report at the end of 1929. This report revealed deplorable conditions and made many valuable recommendations. But it recommended, among other things, tax "relief" for real estate. There began a systematic propaganda, largely fostered and aided by members of the Commission, in which the principal argument ran to the effect that 20 per cent of the property of the state, viz., the tangible property, was paying 96 per cent of the taxes and that the other 80 per cent of the property, the intangible property, was

paying only 4 per cent of the taxes. These figures were given as an explanation of the tax burdens of which farmers were complaining. Farmers were said to be relatively overtaxed *because* intangibles were escaping. One might naturally ask how, if intangible property is almost altogether merely claims on the income of tangible property, Missourians could acquire claims of four times as much value as all the tangible wealth of the state. Were claims piled upon claims like Ossa on Pelion? Or was nearly all of the wealth of Missourians in stocks, bonds and mortgages on factories and farms in *other states*! But, in view of the teachings of an erudite and widely-known economist in a great metropolitan university, to whom students have flocked from all over the world, who shall blame busy men of affairs for failure to comprehend the relationships involved?

In general, then, it can be safely asserted that taxation of intangibles is double<sup>9</sup> taxation and is

<sup>9</sup>Of course *some* intangible property is supported solely by the earnings of labor, as, for example, the promissory note of a man who can give no security other than a pledge of his salary. But surely this does not mean that such a promissory note should be taxed and the propertyless borrower compelled, thus, to pay a higher interest rate!

Perhaps the height of the ridiculous was reached in Missouri when a business man, active in the movement for tax change, attempted to arrive at a large value for "intangible" property by capitalizing estimated total income in the state, including income from *work*, at a

altogether discriminatory and unjust. Were it not that taxes on intangibles are so extensively evaded, their economic consequences would be, patently, so terrible as to bring about their almost certain quick repeal, *with the eager aid of many of the very real estate owners who now think that they desire intangibles to be taxed.*

As things are, however, many real estate owners, including a quite sufficient proportion of farm and home owners, are bitter because more is not collected from taxes on intangibles. To tell them that they are paying taxes which owners of intangible property "ought" to pay, and that "something must be done" about the matter, arouses their enthusiastic support. Or, at any rate, prominent politicians seem to believe that this is the case. For many such politicians are ever ready to make public pronouncements to the effect that, the poor farmer

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seven per cent interest rate, and subtracting the assessed value of tangible property (which was far below its real value). Could a decrepit old man, earning (say) \$700 a year and not likely to be able to work at all for very long, be said to represent \$10,000 of value of untaxed "intangible" wealth! When university-trained business and civic "leaders" talk thus, what may we expect of others!

The fact should not be overlooked, of course, that some part of some intangible property is really the capitalization of privileged monopoly income. The solution here is effective prohibition of monopoly except in industries where monopoly is clearly advantageous, and public regulation of rates or charges in all such industries. A general tax on intangibles is certainly *not* a right solution.

and home owner being, as they contend, over-taxed, *therefore*, to remedy this situation, the owners of intangibles ought to be taxed more.

The ridiculousness of their case as regards intangibles is so transparent to one who has once grasped the relations involved, as to make it difficult to conclude that the politicians who so argue truly believe what they say, and to raise the suspicion that they make these statements merely in order to gain increased political influence. But any such conclusion would be based on the too-hasty assumption that men in public life really understand these problems,—and the truth is that the majority of them do not. They may, indeed, in some cases, *prefer not to understand too well*, since such understanding, when they are conscientious, would compel them to tell the truth and the truth might not always be readily accepted by, or make them so popular with, their influential constituents. In other cases there may be an earnest spirit of public service and a desire to choose the wisest policies. But keen understanding of economic facts and phenomena is not one of the qualifications presented by the majority of candidates for public office. Unfortunately, few of the voters are able to judge the ability of candidates in this regard any better than they could judge of the candidates' ability in integral calculus or physiological

chemistry. Hence the successful candidate for office is too often not one who can see and understand what public policies would be wise, but one whose prejudices and lack of comprehension are such that he can, without doing violence to his own ill-founded convictions, and so with a sincerity that gets for him enthusiastic support, successfully appeal to the prejudices of an uninformed electorate both in his campaign utterances and in his official activities. He may be able to speak fluently and eloquently "of many things: of shoes—and ships—and sealing wax—of cabbages—and kings—and why the sea is boiling hot—and whether pigs have wings"! But to the solution of the most important economic problems he will probably contribute more of hindrance than of help.

But what if, in this situation, a presuming economist attempts in some small measure to enlighten the public, hopeful that the time may come, even though it be far distant, when widespread understanding of basic, yet simple, economic principles, will make it usually impossible for such candidates as we have been describing, to secure high elective positions! Right across the pathway of his purpose lie barriers of confusion, placed there by widely-known professors in great universities, professors whose texts are the most extensively taught and the



most frequently cited, and professors, it may be, upon whom scholastic honors have been heaped through many decades and in many countries.

## §2

### *Taxing Incomes to Relieve Real Estate Improvements and Other Capital*

The last twenty years have been distinguished, in the United States, by a growing popularity of and an increasing reliance on the so-called income tax as a means of raising public revenue. Economists have acquired professional distinction as advocates of such taxation or as "expert" advisors regarding the details of income tax measures. Is it, therefore, a fair presumption that the widespread adoption of income taxation by our state, as well as Federal, governments, indicates economic progress? Is its contemporary popularity indicative of general economic intelligence? Or may it conceivably be the case, instead, that such taxation has been adopted through its falling in with the interests and related prejudices of a dominant property-owning class, and through its real implications being commonly overlooked or not understood?

✓ Whatever may be true of the Federal income tax, the income taxes of our various state governments are looked upon, and are by many persons advocated, as a means of relieving real estate and

other *property* from taxation. One of the recent slogans of real estate owners is: "Tax relief for real estate." We may, therefore, advantageously compare the income tax, first with taxes on humanly-produced capital, including *real-estate improvements*, and, next, with taxes on the site value of *land*.

When property is the sole basis of taxation, only those who have property are required to pay a tax. Normally the tax is low enough so that they can pay it out of the income of their property; and any income they may earn by their labor is free of tax. This is true in principle even when part of the property subject to tax is of a sort commonly reckoned as not productive of income, e. g., the house which one owns and in which he lives and one's household furniture. For these things yield shelter and convenience which the owner would otherwise have to pay for as a tenant occupying a furnished house. The owner living in his own house thus really receives a clear surplus above any income for which he may have to work, and it is really from this surplus that he pays the required tax.

But the *income* tax, as we have been applying it in several American states, rests with *equal proportionate weight* on incomes derived wholly from labor. This tax puts a burden, as the tax on property does not, on persons who have no prop-

erty, who receive no income in money or service from property, whose income is wholly the reward of labor.

Of course it may be argued that many labor incomes are, in part, analogous to incomes from property, because they are enhanced by an investment in specialized training. This is the case, in general, with such professional incomes as those of doctors, lawyers and civil engineers.

But, if so, the income taxes of our various state governments certainly treat income from such investment much more severely than they treat the income from capital.

✓ For a person whose income is derived from a capital investment in tools, buildings, machinery or other such capital, is not reckoned as enjoying any income subject to tax until subtraction is made from the annual gross yield of his capital sufficient not only for necessary current repair expenses but also for a depreciation or replacement fund. And this depreciation fund is supposed to be large enough, by the time the capital instruments are worn out, to replace them with new ones of equal value.

Thus, if one owns a factory worth \$100,000 from which the gross yield (after paying wages and for raw material and power) is \$12,000 a year and if necessary repairs are \$2,000 and depreciation is at the rate of \$3,500 a year, then only

\$6,500 is regarded as income subject to tax. In other words, the owner of the factory, if he carefully lays aside each year his allowance for depreciation, will normally receive, he and his heirs, a *perpetual* net annual income of \$6,500; and only this (potentially) *perpetual* annual income is reckoned as income at all for the purpose of taxation.

How is it with the income that a man derives from his investment (or that of a parent) in his professional training? If depreciation were allowed analogously to the allowance in the case of property income, nothing would be reckoned as taxable income until enough had been subtracted from the annual earnings so that, if accumulated and invested, it would replace, on the average, at the end of the professional working life, the investment in education.

But merely to repay the investment in technical training would not be to treat labor income as well as income from capital. To do that, the entire net earning power, and not merely the extra income due to specifically professional training, must be regarded as the yield of a piece of capital the value of which is to be kept constant. In other words, enough must be allowed from the gross income of the labor so that, if this allowed sum were laid aside each year, the total amount so invested would produce an average perpetual

✓ annual net interest, after the death of the worker, equal to the remaining annual income during the worker's life time. Only this remaining net income, the part which would be perpetual if something analogous to a depreciation fund were provided for, could be regarded as income for ✓ purposes of taxation,—if labor income were treated as generously in our income tax laws as income from capital *is* treated. Do we thus treat with equal generosity the income that has to be earned by *hard work*? Everyone knows that, so far as the *income tax* laws are concerned, we do *not*. If, as yet, there is no pronounced prejudice against labor incomes, this is because taxes on property are still so largely relied on for public revenue.

Perhaps it will be said by some critic, friendly to our current income taxes and their further ✓ development, that there is a measure of allow- ✓ ance, analogous to capital depreciation, in the exemption of a fixed sum for each dependent ✓ child. But this exemption is made equally if the income in question is solely an income from property. And it is then *in addition to* an allow- ✓ ance for depreciation of the property yielding the income. In other words, if income from labor were to be treated with equal generosity, there ✓ would be allowed an exemption for replacement or for depreciation of earning power as in the

case of income from capital and *also*, as in the case of income from capital, a *further* exemption for each dependent child. But this is not done.

The truth is, of course, that the allowance for dependent children is not made on the basis of replacement or depreciation but on the basis of a feeling of humanity, not fully worked out or equally applied. It may be true that this feeling is given superficial expression in the phraseology about "ability to pay" taxes. But that labor and property are not treated equally, in our income taxes, on any basis of "ability," should be sufficiently evident.

✓ The discrimination, in income taxes, against income earned by labor and in favor of income on capital is, indeed, even greater than has so far been shown. For, in the case of income on capital, allowance is made not only for depreciation but also for current repair costs to keep the capital serviceable until it is so far depreciated (or obsolete) as to require replacement. And before any income from capital is reckoned as net income subject to an income tax, there is subtraction of all repair costs *as well as* depreciation allowance.

✓ How is it with labor income? Such income is absolutely dependent on the functioning of the mind and body of the worker. The worker, as much as any capital, must be kept in "repair." If

our income taxes were as lenient on labor incomes as they are on capital yields, they (the income taxes) would allow to the worker enough to keep himself efficient during his working life plus enough to provide a depreciation fund making his true net income<sup>10</sup> perpetual, before there was ear-marked any net income subject to tax. And if, in addition to an allowance for repairs *and* an allowance for depreciation, there is, in the case of income from capital a *further* allowance or exemption of (say) \$1,000 for a single person or \$2,000 for a married couple, then an income from labor is not treated with equal leniency unless there are corresponding allowances of all these kinds. How fully do the considerations here noted, enter into popular thinking on income taxation?

Doubtless there are other aspects of the problem. Humanitarian considerations, for example, may *sometimes* apply especially in favor of income from capital, as when such income is received by a widow with small children needing her care, so that she cannot well supplement it with an income from work. Yet there are other cases where an income from property is received

<sup>10</sup>Which would then have to be reckoned as not including his own personal living costs since, by this reckoning, they are counted as repair costs and not as net income.

by a person well able to work but who does not work, and if, in such case, there is an exemption for self support, although the income is *not due to the recipient's ability to produce*, besides an allowance for capital depreciation and repair, why should there be any less exemption and allowance when the same income is produced by labor?

The problem of discrimination against labor incomes and in favor of incomes on capital may seem to some persons of little importance in view of the fact that current exemptions are high enough, in the United States, to free the lowest wage groups from any direct income tax burden. ✓ But to the middle classes the discrimination has some importance. The professional man, or the ambitious young business executive who is able to command a fair salary but who has, as yet, been able to accumulate scarcely any property, finds it harder to save. Even the skilled artisan does not always escape.

The trend seems to be away from the idea of putting tax burdens on those who already have property, except when their income from property is very large, and towards putting them on the aspiring and hard-working middle class. Thus is made more difficult the ascent of the latter on the ladder of capital accumulation and economic success. Such a result is politically possible partly



because the matter is too complicated for general understanding—the common man feeling that a tax based on income is on a right principle. And partly it is possible because so many of the working classes, who might otherwise feel the income tax a discrimination, receive incomes so small as not to be subject to the tax and are willing enough to have the doctor, the lawyer, the civil engineer, the accountant and the young business executive taxed the same per cent as the recipient of income from investment.

Nothing in the above argument is to be taken as indicating that interest on capital is an ideal source of public revenue or that, if corresponding allowances and exemptions are made in both cases, it should necessarily be any more heavily burdened than income from labor. There is no intention, here, of expressing the slightest sympathy with the socialist notion that interest on capital, as such, is an unearned income or the gain of exploitation. Capital adds greatly to the output of industry. And capital comes into existence only by saving. The person who works and saves and who thus is instrumental in bringing capital into existence, does more to increase the output of industry than the person who works with equal efficiency but who does not save. If, doing more for production, he receives a larger part of what production yields, this does not rob

anyone else. The socialist view that interest is an illegitimate income cannot be endorsed. Hence we have no reason to conclude that the state should—even if it could—confiscate all interest by taxation or otherwise. But it is none the less important to point out that our income tax laws do not make for labor incomes such allowances and exemptions as for incomes from capital and that an extensive, though gradual, displacement of taxes on capital by income taxes of the kind currently levied must unduly burden labor incomes.

In so far, of course, as future income taxes of our states and of the Federal government, make a sharp distinction between incomes from property and incomes from labor, and levy upon the former at a higher rate (and, to a very slight extent, our present Federal income tax does this), the basis for the criticism made above is removed. But unless there is a radical discrimination made between these two kinds of income or unless the income tax is but a relatively insignificant source of public revenue, there being a sufficiently heavy tax on property so that the tax system as a whole makes full proportionate allowance to labor incomes in all the matters which have been herein above discussed, a large part of the criticism remains valid. And the reader must bear in mind, also, that our whole discussion so

far has reference to the question of the relative tax burden on income from labor and on income from constructed capital, i. e., from goods and equipment made by human beings. *The question whether it is desirable to tax labor incomes in order to relieve site rent, i. e. land value, of taxation, is yet to be considered.*

It will doubtless be obvious to the reader, without any elaborate argument, that all which we have said regarding income taxes as substitutes for taxes on capital, applies with as much, if not greater, force, to taxes on goods and on amusements. Such taxes fall on labor incomes no less heavily than on any other incomes. They are borne, in proportion to expenditures for the taxed goods and amusements, by all who purchase and enjoy them. And whereas it is possible, in the case of an income tax, to levy a different rate on income from property than on income from labor, no such discrimination can be made in the case of any tax on commodities and amusements.

### §3

#### *Taxing Incomes to Relieve the Site Value of Land*

But the growing reliance on income taxation means *not only* a partial substitution of taxes on labor incomes for taxes on capital. *It means also a partial substitution of taxes on labor incomes for*

*taxes on the site value of land.* Are there any special consequences for good or ill likely to flow from such substitution?

We must inquire into this matter carefully, bearing in mind that many able economists have made a sharp distinction between land and capital. If the distinction is at all valid, it may turn out that the relief of land from taxation, the extra burden being put upon labor incomes, involves special consequences, whether for good or evil, different from those involved in relieving capital.

The first point to be made in this connection is that the rental yield or the rental value of land is in a peculiar degree a social product. "Land is valuable because of natural advantages of location and because of community growth and development. The latter influence is recognized wherever the phrase 'unearned increment' is current. We all know that the annual rent which an owner could charge for a piece of bare land in Chicago's central business district known as 'the loop,' to a prospective builder desiring a long lease, is not a consequence of the owner's saving the land or making the land, but is the consequence of the growth of Chicago and surrounding territory. An eighth of an acre at a busy Chicago corner was expertly appraised, some years ago, as worth, bare-land value, about two and a half mil-

lion dollars or at the rate of twenty million an acre. ✓  
Wherein is such an eighth of an acre better than an eighth of an acre of farm land worth five or ten or fifteen dollars? Is the additional value of the land in Chicago due to the owner's activities? Everyone who is honest with himself knows it is not. It is the result of the growth and development of the geographically tributary country, and of Chicago as a port and a market center.

"The same is true of the several billions of dollars of land value in New York City. New York is situated on a great natural harbor. If there were none to use it except a few pioneer farmers on Manhattan Island trading some of their surplus produce for the textiles and other goods of Europe, landing space for a very few boats or perhaps for a single one would be all that would be needed. But as the rich interior of the North American continent was settled, with its mines of iron ore, copper and coal, its prairie and river-bottom wheat and corn lands, and its other resources, more and more goods were produced to be poured through the port of New York into foreign countries and more and more foreign goods were wanted in exchange which could most advantageously pass through the same port. Today there is needed in New York City a large population to meet the requirements of this great *hinterland* or tributary country.

“The demand of the tributary country for this service makes a demand for the use of the land by the people who must live and work there to render the service. Incidentally, too, it makes a tremendous demand—and correspondingly high rents and values—for the use of especially well-situated lots for the location of department stores, lunch rooms, banks, lawyers offices, etc., necessary to supply near-at-hand the requirements of those who live there to serve the non-sea-coast sections.

✓ “Surely the rent of land is in a very peculiar sense socially produced rather than individually earned, and ought to be sharply distinguished in thought from interest on capital produced by individuals. And thus, if there is any kind of return which is peculiarly fitted to be a source of public revenue, it would seem to be the rent of land.”

How silly—how utterly naïve—those erudite economists who are forever hinting that land-value taxation is an *agrarian* reform of no moment in our highly-developed and largely urban civilization!

What now of the trend in favor of income taxes? These taxes, in so far as, without them, heavier taxes would be placed on property, operate, in part, to the *relief of land*, and put an ✓ *extra burden on income from labor*. Is this a

forward step or a backward one? How far is it desirable to put an increasing burden on incomes from labor, even though the very poor are exempt, in order that individuals who own valuable sites may derive a larger, because less taxed, income from these sites, *an income which is produced almost wholly by the community* and for which, in general, the favored individuals are personally not at all responsible? How largely should the earned incomes of professional men, highly-skilled workmen and others be burdened, in order that less burden may be imposed on the incomes that landowners get through their ability to compel others to pay *them* for advantages of situation which the *community* has given?

But there is another aspect of this question which we can by no means afford to overlook. This is its relation to the salable value of land. To tax incomes from every source at equal or substantially equal rates and so burden labor incomes more and site rent less, tends to make the price of land or sites higher.

This fact never so much as enters the minds of most supporters of income taxation. But perhaps their faith in such taxation would not be weakened if it did. For high and increasing land prices are commonly looked upon with equanimity, even with exultation!

But are high land prices properly a cause for

✓ satisfaction to those who are not land speculators, to those who are interested rather in general social well-being? Before raising this question it may be worth while for us to inquire just why such a change in the taxation system does tend to make land prices higher. Since this latter inquiry is a purely arithmetical one, we should be able, at least until we have completed it, to keep passion and the bias of class interest out of our minds.

In order to make "perfectly clear" how the value of land is determined, we may advantageously distinguish between the conditions fixing land value and those fixing the value of capital. ✓ The distinction between land (in the strict economic sense) and capital is a real and an important one. ✓ Capital includes all tools of production brought into existence by the effort and thrift of human beings. It includes buildings. It includes planted trees and the fertility put into land by the owner's effort and investment or restored and maintained by the owner's care and thrift. The bare land is a gift of nature. Since capital has to be produced, its value depends on its cost of production, whereas land has no cost of production and its value is dependent solely on its expected future income. ✓ Of course the value of capital, also, is related to the prospect of income. An unseaworthy ship does not have high value



just because its cost of construction was high, and a railroad built through a desert may have little value despite a high cost of building. Yet in the long run and on the average there is certainly a close relation between the value of capital and its cost. Competition tends to bring about a price for any capital which just about covers the cost of producing it, including in cost the ordinary "profit" to the producer. Indeed, no one will go on year after year producing capital instruments to sell for less than their cost; and no one, unless he has a monopoly, can go on year after year charging much more.

But the value of land has no relation to any cost of production, since the land was not humanly produced and is not reproducible. The would-be buyer of land asks only how much net return he is likely to be able to make from it. Such an expected net yield is then capitalized at the prevailing rate of interest. However much the community may grow, capital cannot rise in value except as the cost of producing it increases; while land rises in value as and because the community grows and develops, and in proportion as roads, subways, railroads, schools, etc., are built around, through and in it. A business block in the center of a great city is valuable (bare-land value) not because of the activities of those who own that particular piece of land,

but chiefly because of the way in which others settle about it. The development of the environing areas enables the owner of that block to enjoy larger rents, and the possibility of enjoying these rents gives the privilege of ownership value and makes the land sell for a high price. Individuals create the value of their capital by saving and constructing the capital. *Nature and society create the value of land.*

This distinction is fundamental. It is probably every bit as important—perhaps is far more important—in the most highly evolved modern economy as in an economy of a more primitive order. Neither the existence of more complicated machinery than that of earlier peoples nor the spread of joint ownership of property through corporations, as contrasted with individual ownership, should blur this distinction between capital value and community-produced land value in the mind of any careful student of economic phenomena. And, surely, it should be clear to any such student that where incomes are derived largely from the ownership of the securities of corporations possessing both land and capital, income taxes imposed on the *individuals* who receive such incomes, are *not* adapted to separating and distinguishing between income from capital and income from land. In taxing *corporation* income it *might* be possible,

although in our system of government the difficulties would be very great even if not insuperable, to estimate, in the case of each corporation, approximately what proportion of its income should be reckoned as economic rent, and to make the tax rest chiefly on this part of the income. And the incomes of individuals from their tangible property *might* likewise be *roughly* so divided. Either such a distinction should be made or it should not. No one who thinks it should be, can be wholly pleased with the tendency to greatly increased reliance on *income* taxation, if such reliance is likely to prevent or make more difficult, as it almost certainly must, the putting of the chief burden of taxation on the value of land. ✓

And what shall we say of economists calling themselves "institutionalists", whose understanding of our economic system is so superficial that they can see only the institution of corporate ownership in general and fail entirely to see or to help their students to see the nature and significance of the institution of private appropriation of community-produced land values? Are they not, indeed, "institutionalists" with a blind spot for the most significant and ominous of institutions?

Certain antagonistic economists who probably think of themselves as thoroughly "modern"

and as "emancipated" from the classical notion of a distinction between land and capital, have developed a contention that "available" land is as much humanly produced as any capital. The argument is that, although geological forces may be the explanation of the physical formation of the earth, nevertheless the situation advantages, and so the practical availability, of any piece of land, are due to human effort. Land is admitted not to be humanly produced, but all its desirable qualities are said to have been so produced, or, at any rate, to be reproducible.

No one can deny, of course, that the building of roads and railroads and the way in which population is distributed near or about a given piece of land affect the usefulness of that land for production, and so affect its value. Indeed, that land value is largely a community-produced value is one of the very facts we have been emphasizing.<sup>11</sup> An individual or a comparatively small group of individuals may produce or reproduce a house, a machine, a factory or a locomotive. But no group that does not approximate a hundred millions in numbers can produce, or reproduce, the situation advantages of Manhattan Island. Such situation advantages are, in the

<sup>11</sup>Ely says (*Outline of Economics*, fifth edition, New York—Macmillan—1930, page 444): "No land is economically utilizable which does not represent human toil of some kind. For example, land can-

main, by-products of activities not directed to the end of producing these advantages. When all superficial resemblances are allowed for and all qualifications made, as for individually-produced goods having non-duplicable associations (e. g., Washington's home at Mount Vernon!), it remains true that there is, in general, a most significant distinction between land and capital, a distinction of the greatest importance for public policy.

But perhaps it will be said that land may be increased in practical effect when we learn how to use it to more advantage so as to get a larger output from a given piece of land. A better

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not be put to economic use unless we have access to it; and the efforts involved in creating means of access often constitute a very considerable part of the cost of making land economically utilizable; land may thus be said to be 'produced', and to be the result of 'stored-up effort'."

✓ How utterly irrelevant is all this to the real problem about land rent! If landowners alone paid the entire cost of "creating means of access" to their land, such as building all the railroads, roads, bridges and wharves required, maintaining them, and replacing them when worn out or obsolete; if the various owners paid, each, in proportion to the increased land value received by them; and if the total capitalized land value did not exceed the reproduction cost, minus depreciation and obsolescence, of these "means of access", then Ely's discussion would have relevancy to the problem of private enjoyment of land rent. But do Ely and his collaborators (including T. S. Adams, a taxation advisor) take pains to consider all these matters? They do not. Yet they endeavor to contrast "the older concept of rent" with what they are pleased to call "modern ideas concerning land income"!

way of expressing such a condition would be to say, not that such new knowledge increases the supply of land but rather that it tends to decrease the demand for it. The principle applies, of course, to buildings, steamships, or any other kind of capital. If a better type of freight car, better grease for car wheels or improved bearings, should make it possible for a single locomotive to draw many more cars, the demand for locomotives might appreciably decline. But while increased knowledge may enable us to use more effectively either land or some kind of capital, it still remains true that the *production, or the reproduction*, of the first is *practically impossible*, while the production or reproduction of the second is possible and is *almost an everyday occurrence*. Teachers of economics ought to contribute more than any other class to clarifying public thinking and opinion on economic problems, and especially on the most fundamental of them. How long will it be the case that many such teachers are merely *adding to the confusion*,—except, possibly, on relatively inconsequential matters which involve no crucial conflict of interest?

To illustrate the dependence of the value of land on its net rent, let us suppose a piece of land which is expected to yield, to the owner, \$8,000 per year. This is site rent alone. That is, the

land and the improvements together may yield \$12,000 or \$18,000, but, of this, \$8,000 is attributable to the land or site as such. In other words, there is a return from the use of improvements, ✓ above the normal current rate on their value, *due solely to their situation*, and this return is economic rent or site rent. But taxes on the land take, annually, \$3,000, leaving the owner \$5,000 on the land. The current rate of interest is, we shall suppose, 5 per cent. Then the land is valued by capitalizing this net rent, \$5,000, into a salable value, using the current interest rate in the process. This makes the land worth \$100,000, the sum of which \$5,000 is 5 per cent. (Of course an expected rise in rent would make the land worth more, or an expected fall, less.)

Suppose, now, that heavier taxes are laid on labor incomes and that, therefore, it becomes possible to relieve the owner of the land of part of his former tax, reducing this to \$2,000 so that the net rent of the land is thereafter \$6,000 instead of \$5,000. Then the land will come to be worth that sum of which \$6,000 (and not \$5,000) is 5 per cent. This will make it worth \$120,000, or more than before by \$20,000.

Putting an extra tax on incomes which have to be earned by work, and thus somewhat relieving ✓ of taxation the rental incomes from land, operates to *raise the salable value of land*. Re-

Relieving land of taxes makes the land sell for enough more so that such relief is no advantage at all to future buyers of the land who may have saved long years to be able to buy it. Though their taxes on the land will be lower, the purchase price they must pay for the land is higher. More than this, *the heavier tax on labor incomes makes it harder to save enough to buy a piece of land for a home or a business.*

Relieving land of taxation also in so far removes the penalty on land speculation. Thus, it tends to foster such speculation and raise rent, and to raise the price of land still further.

People are constantly boasting about the rise in land prices in their towns or states, as if this were desirable. "Come to our town", they say, "It's a fine place; land is going up in price by leaps and bounds." But if bread and meat, or potatoes, are rising in price in their town, people do not boast. Land, too, is a necessity of life. Is it so advantageous to have it expensive?

The truth is that *high land prices are an economic and a social calamity.* They make it harder for the struggling worker to purchase land for a business, a farm, a home. They accentuate the trend towards tenancy as against ownership by the user of the land. Taken in conjunction with a higher tax on incomes from labor they penalize those who are serving the



community with mind and body and retard their saving. Relieving land of taxation furthers ✓  
 land speculation, makes available land scarce, ✖  
 crowds men, women and children into slums where inadequate air, sunshine and playground space curse the rising generation, makes rents high to tenants, makes the acquisition of land hard, makes for an agricultural population of tenants instead of independent owners. No one whose mind grasps the simple mathematics of land value determination can possibly fail, if he is willing to lay aside prejudice and really try, to understand how relieving land of taxation tends towards these evil consequences.

If incomes which must be earned by labor were not taxed and if consumers were not taxed through levies on various goods they buy, so that all taxes fell on the owners of *property*, there might be more hope of a reform which would put the tax burden chiefly on the economic rent of land. For, after all, it is the owners of property who seem to be, in the main, the influential class. And it might be possible to make them see the advantage of taxing land or site values *rather than* improvement values. *But give them the idea that it is politically possible to put the tax burden more largely on labor incomes, either through income taxation on labor incomes above a fixed minimum or through commodity and sales taxes*

resting on even the poorest workers,—give real estate owners this idea and their interest in “tax reform” is likely to be confined to advocacy of these substitutes for the property tax. “Tax relief for real estate” becomes their slogan, *with no distinction between improvement values and site values.* ✓

And so, if a state needs more money for the proper functioning of its government, for the building of hospitals and prisons, for the improving of the public schools, and for increasing the efficiency of the state university, the idealists who see the need for all these things are frightened away from an attempt to secure them by increasing, or, perhaps, even maintaining, existing tax rates on community-produced land values and they readily consent to—perhaps actually urge—increased taxes on consumption and on incomes as the easiest and quickest way of attaining their ends. Thus we find school superintendents *et al*, who have never made any extensive study of economics, joining in the hue and cry to relieve land of taxation!

For it is assumed that the masses will pay their commodity and sales and amusement taxes more or less unconsciously, in the prices of the goods and services they buy. The poorest are placated by the exemptions in the income tax. And those having larger incomes from labor are

made to believe that an income tax is based on "ability" to pay and so is an ideal tax. Few take the trouble to analyze incomes, to distinguish between types of property and to reach well-grounded conclusions regarding the differing ultimate effects of different kinds of taxes.

The taxation of incomes, when such taxation is made progressive and when proportionate allowance is made in the case of labor income for what corresponds or is analogous to depreciation on capital as allowed to recipients of property income, does appear to conform to the contemporary idea of "ability to pay." But such "ability to pay" *can by no means* be accepted as a *sole criterion* either of justice or of expediency in taxation. Not only is the ability-to-pay idea essentially communistic so that, if carried far, it would deprive of reward and, therefore, largely, of motive, both efficiency and thrift; but, further, the principle of ability, as commonly understood, *fails to distinguish* between incomes *earned by service* to the community and incomes *not earned by such service*. It makes *no slightest distinction* between interest on capital brought into existence by *individual work and saving*, on the one hand, and, on the other hand, the *community-produced rental value of land*. No trained economist, not even the conservatively antagonistic disciples of Professor Edwin R. A.

Seligman(!), should be oblivious to this tremendously important distinction. Equal taxation of income from land and of income from capital makes possible, too, a high salable value of land and so *makes ownership of land and homes as difficult for the masses of men as possible*. Who, among those that think not alone of their private selfish gains but also of the public welfare, will venture to call such taxation ideal? Does not the school of Seligman, T. S. Adams, Plehn, Lutz and Hunter, while constantly stressing the idea of "ability", practically ignore some of the *most important* considerations which ought to be kept in mind when judging any tax system?

We need not go so far as to assert that a graduated general income tax is *never justifiable*. Thus, should a tax of close to the full rental value of land, together with a wisely graduated inheritance tax, prove to yield less than the revenue needed for important governmental services, *there might seem to be good reason for supplementing such a land-value tax with a general tax on incomes*. But the taxation of earned incomes, whether from labor or capital, even the steeply graduated taxation of such incomes, *in order that private individuals may enjoy, permanently, any large part of the community-produced rent of land and in order that the community may be cursed with a high salable value of land, is*

certainly *not* "progressive" or liberal or economically wise.<sup>12</sup> And the advocates of such a system, whatever their degrees or pretensions, are utterly superficial in their economic analysis.

#### §4

#### *Taxing Commodities, Amusements and Sales, in Order to Relieve Real Estate*

Despite the extent to which commodity taxation is discredited among professional economists—and there is not yet, apparently, absolute unanimity even there—such taxation still has considerable support among conservative people of large means. These people perhaps rather easily persuade themselves that they are paying too much of the taxes. And they vaguely feel that taxes on goods would be less burdensome to them. Even some of the small owners of so-called real property may be persuaded by the slogan "tax relief for real estate" to support such commodity and amusement taxation. They perhaps believe, what is the fact, that such taxation puts a considerable part of the burden of supporting government on persons who *own no property at all* and have only small labor in-

<sup>12</sup>It is disappointing to find in *Modern Economic Society*, New York (Holt), 1931, by Professor Sumner H. Slichter of Harvard, reference to "the hope . . . . of relieving real estate from its unfair burden", with no accompanying distinction between site values and real estate improvements.

comes. Partly because it may thus have the support even of the small property owners and partly because it is paid by consumers more or less unconsciously in the prices of goods bought, such a tax may be difficult to abolish when once a community is accustomed to it.

That such a tax does raise the prices of the taxed goods to consumers should be obvious with only a little analysis.<sup>13</sup> Take, for example, a tax on all coal at the mine mouth, of \$2 a ton. This would make it unprofitable for some of the poorer mines to operate. Labor and capital engaged in coal production would also tend to receive somewhat less than before compared to what they could receive in other lines. They would, therefore, quit mining coal and would engage in other industries. Coal would be scarcer. The price of coal would rise.

Or suppose the tax were 20 cents a yard on all cotton cloth. This would cause some of the labor and capital and land engaged in producing cloth to change to other lines. There would be less cloth. The price would be higher. The high price would, of course, somewhat curtail the demand, but, obviously, the public would have to pay a higher price because of the tax or even more people would leave the business and there

<sup>13</sup>For a fuller discussion see my book, *The Economics of Taxation*, New York (Holt), 1924, Ch. III.

would be hardly any cloth available at all. As long as they were free to engage in other industries, hardly any persons would consent to produce cloth, sell it at the same price as before, and pay a tax of 20 cents a yard.

That taxes on such specific goods or services as soft drinks or amusements, also fall mainly on consumers, should be sufficiently obvious. Where the margin of return is narrow, manufacturers and sellers cannot pay any considerable tax on output or sales and continue in the business. Consumers *must* pay the tax or go without the goods.

And so with gasoline, tobacco, wheat, corn or cotton. A tax on wheat would certainly tend to decrease the output of wheat by causing some wheat farmers to produce less wheat. These would not necessarily all abandon farming. They might simply produce other crops instead. The result, in either case, would be a higher price of wheat.<sup>14</sup>

One of the most amazing passages in the writings of academic economists is that in which Professor Edwin R. A. Seligman of Columbia University, most widely quoted of American writers on taxation, discusses a supposed tax on

<sup>14</sup>Although, of course, since wheat has a world market, a tax levied in only *one* producing country would have relatively small effect.

wheat of 5 cents per bushel.<sup>15</sup> Says Professor Seligman:

“Suppose that in three countries, A, B and C (let us say the Argentine, the United States and England), the cost of producing, irrespective of taxation, a bushel of wheat at a given time is 50, 70 and 90 cents, respectively, and that the conditions of the market are such that the wheat sells at the moment at 70 cents a bushel. If a tax of 5 cents a bushel is imposed in each of these countries, what will happen? In the long run, indeed, the tendency would obviously be for the price to rise to 75 cents. The long run however, may never come to pass. The producers in country A, who have the whip hand, may fear that if they put up the price to 75 cents they may spoil the market for the next year, by inducing

<sup>15</sup>In *The Shifting and Incidence of Taxation*, fifth edition, New York (Columbia University Press), 1926, p. 268.

Among various other peculiarities of the same book is the concept of inelastic demand (pp. 228-9). After stating that demand is called elastic “when a change in price produces an alteration in demand,” Professor Seligman goes on to say that inelasticity of demand “may assume two forms.” The inelastic demand may be a demand which is constant or “it may be inelastic in the sense that any increase completely destroys the demand.” Taking this statement in connection with the discussion that follows it (especially, p. 232), it appears that Professor Seligman regards demand as elastic in proportion as it is sensitive to price changes, and the more sensitive the more elastic *up to* the limit of sensitiveness, but that if the sensitiveness is the *greatest possible* then he regards the demand as inelastic!! In other words, the nearer the variable approaches to a limit which is defined as *inelastic*, without reaching it, the greater is the *elasticity*!!



country B to increase its acreage or preventing C from diminishing its output. This consideration, together with the fact that they are already making large profits as intra-marginal producers, may lead the producers in A to be content with the old price, despite the tax."

There are many things unreal about this illustration. But all it is desired to emphasize here is the fact that Professor Seligman seems to have completely overlooked the effect of the tax on supply (through influencing which a tax causes price to rise) and the fact that he has imagined a perfectly ridiculous attitude on the part of farmers.

To suppose that a special tax on wheat growing would not tend to reduce the supply of wheat is preposterous. And if the supply is reduced, the price will be higher than if there had been no tax. The farmers of country A certainly will *not* "be content with the old price." They will sell their wheat, as always, for the highest price they think they can get. They will sell it at the ruling market price, unless they expect to get even a higher price later by holding it. Imagine a group of farmers sitting around the cracker barrel at the village store and saying one to another:

"Well, looks as if we could get maybe 74 cents or more for our wheat this year, but we'd better offer it to the grain dealers for 70 cents.

If we don't those fellows over in country B may raise more wheat next year."

Are we to suppose that the above is Professor Seligman's idea of how farmers' minds work? If not, *what can he possibly mean* by his illustration? Does he *really* think that *not a single farmer* would be influenced by the tax to produce less wheat, and to produce, instead, other crops? If less wheat were thus on the market and the farmers *did*, by some freak of psychology, insist on selling it to the grain dealers for as low a price as before, does Professor Seligman honestly believe that the grain dealers would also sell it to millers and the public generally at as low a price as before? Are our markets controlled, not by observed processes of the human mind, but by magic!

We have seen that a tax on the production of goods of any special kind tends to raise their price by driving some of the producers into other industries and making the taxed goods scarce. ✓ A tax on *all* commodities or on *sales in general* cannot do this, for there are no other (i. e. un-taxed) industries into which the producers may go. It does not decrease the supply of goods,<sup>16</sup> for producers cannot afford to be idle. It does not increase the money available for the purchase of

<sup>16</sup>We are ignoring purely temporary or transitional effects, if any, during adjustment to a new tax.

goods. It does not tend, therefore, to make the general average of all prices higher. But the share taken by government of the sale prices of all goods *reduces the amount available* for the payment of interest, rent, and wages.<sup>17</sup> The employer, whether manufacturer, miner, or farmer, finds, for example, that the output of each laborer is worth less to him because of the tax and he cannot afford to hire men whose output is worth less than their wages. Except as wages are somewhat lower, the demand for labor must decline, unemployment appear, and competition of the unemployed for jobs bring the required lower wages. And there will likewise be a tendency to decrease the amounts that producers can pay for the use of land and capital. Therefore, a tax on all commodities or a general sales tax, tends to fall on incomes of all kinds. Thus it resembles a tax on any one kind of goods which, when it raises the price, is said to fall on consumers. For consumers are recipients of all

<sup>17</sup>I very much regret that in an earlier article and in the first printing of my book, *The Economics of Taxation*, New York (Holt), 1924, this conclusion was not quite properly developed. The book has since been corrected. If *exports* are *exempted* from an otherwise general tax on sales or on output and are not discriminated against by foreign countries, so that the interest, wages and rent which can be realized by production for export are not directly reduced by the tax, then production for export will be preferred unless and until prices on the taxed domestically-sold goods rise. But the ultimate burden will still be on interest, wages and rent.

sorts of income, some of wages, some of interest, some of rent, some of all three.

Thus the conclusion that a tax on the rental value of land is a better means of raising revenue than is a tax on commodities or on sales does not depend on a demonstration that a tax on output or sales raises the prices of the taxed articles. For, in any case, a tax either on specific commodities or on sales in general falls not alone on the rent of land but also on the interest of capital and the wages of labor. If a tax causes the price of the taxed goods to rise, then all consumers of these goods, *even to the poorest laborers who receive no income but their wages*, really pay a tax in buying the goods. If a tax on commodities or sales does not cause their prices to rise—and we have seen that a general commodity or sales tax will not—, then not only the rent of the land used in producing the goods but equally the interest on the capital used and the *wages of the workers employed, must be reduced by the tax*. So the real question, in either case, is whether we prefer a tax which rests mainly or entirely on the rent of land or a tax which rests with equal weight on the yield of humanly-produced capital and on the earnings of labor.

Are there not clear and distinct differences among these three sorts of income,—wages, interest and rent? Here is a laborer who pro-

duces wheat or coal or shoes, who by his toil adds to the sum total of goods which may be enjoyed. Here is a thrifty person who, by his work and his saving, has brought into existence capital, i. e., equipment, which aids labor and makes labor more effective. Without his saving, this capital could not have come into existence. He, too, has contributed to the productive process. ✓

But consider, now, a third individual, who owns a valuable site in the heart of a great metropolis. He did not bring the land into existence. Geologic forces formed it ages before his infant eyes saw the light. He did not make the land valuable as an ideal location for industry. Millions of his fellows did that by building roads and railroads, by deciding to live and work at various places in the surrounding area, by establishing industries at such points that the owner of this particular piece of land finds its situation ideal for a bank or a department store. His income from it may approximate a half-million or a million dollars a year though he add nothing whatever to the output of industry. He reaps where others have sown. He compels men to pay him, not for what he does or has done, but in order that they may have the privilege of producing goods, of conducting industry, on a site which community development has rendered advantageous. Production can be carried

on most effectively on well located sites. But those who own those sites have the legal power to keep them vacant. They have the legal power to forbid production on them except as these owners are given a large income. The owners are paid, therefore, not for contributing to production but for *allowing* land to be used for it, and not for advantages they have given but for *advantages due to geologic forces and community development*.

Persons whose incomes are thus derived may well, from a narrowly selfish viewpoint, urge that public revenues be secured by taxes on commodities or on sales. They may well try to convince the rest of the public that it is fair to tax at equal rates incomes from all sources, and that it is unreasonable discrimination to tax the rent of land more heavily than wages. There may be professional economists who have insufficient power of analysis to see the real basis for distinguishing among the various kinds of income. But no one who has once thoroughly grasped the distinctions above emphasized and who is primarily interested in the welfare of the people generally rather than of a narrow class, can possibly fail to see that a commodity or sales tax is far from being the ideal. Without contending that no such tax should under *any conceivable circumstances be levied*, we may certainly

contend with confidence that, unless in most extraordinary circumstances, such a tax should never be made a very significant part of the revenue system. Nor should this result be attained *indirectly through city ownership of water and electric light plants* and the compelling of consumers of these services to pay, *in the rates charged*, for expenses of government which ought to be met by taxes on the rent of land.<sup>18</sup>

And yet we are constantly considering pleas that various taxes on consumers be substituted in part for land-value taxes or that they be used to supplement taxes on land so that the latter need not be raised when additional revenue is required. It appears that our sympathy goes out to the owner of city business property whose land is rising in value as the city grows; so we plan to relieve him of taxes on this land and to tax, instead, the amusements enjoyed by the children of the laboring man who owns no business and the cooling summer soft drinks enjoyed by chil- ✓

<sup>18</sup>This is an argument against public ownership of public utilities that is not often put forward by the spokesmen for the public utilities companies. Yet if the landowning interests of a town or city, through their dominating influence on its politics, are likely to use public ownership chiefly as a means of raising money for local government expenses—and some towns thus secure all their local revenue—, so leaving to individual landowners a large part of the community-produced rent of land, the poorer citizens may be worse off than with a considerable degree of exploitation by privately-owned water, electric light and other public-service corporations.

dren whose parents cannot afford to send them to the seaside or to the mountains or to inland lakes and woods. We are immensely sorry for the farm owner who feels that farm products are selling at too low a price; so we devise schemes to relieve him by taxing the few luxuries of the tenant farmer who has no farm of his own but pays rent for the use of one to its owner. We commiserate the condition of the city home owner and of the owner of vacant lots which are rising in value from community development, through no effort of his, while he retards this development by holding the land out of use for a still higher price; hence we seek ways of relieving such real estate owners, and turn our attention to possible taxes on goods purchased by the poor who own no vacant lots and no homes but pay rent to others that they and their children may have a place to live. While tearfully protesting our concern for home ownership, we plan not only to tax goods that home owners consume, but also, by reducing land taxes, to make land expensive and its acquisition by would-be home owners more and more difficult.

Or do we urge these indirect taxes not altogether through sympathy with landowners but partly because of a feeling that only in this way can we secure needed revenue for the state? We notice the constant demand that there be "tax



relief for real estate." We see that owners of real estate are politically powerful. We fear that their desire to avoid taxation will effectively block our plans for increased revenues for better prisons, hospitals and schools. And we are of the opinion that the poor are likely to be more amenable.

While these various proposals are being agitated, the value of city land moves steadily upward. Also, from city to city, we are constructing concrete highways paid for from taxes on gasoline,<sup>19</sup> and so *raising the value of the land*

<sup>19</sup>In recent years there has been a wide extension of the gasoline tax as a means of building and maintaining concrete and gravel state highways. It has been contended that this is a fair arrangement on the ground that the motorist pays, in the tax, for an expense entered into on his account and that it is as reasonable for him to pay for the upkeep of highways as for the user of a railroad to pay, in the rate charged, for the upkeep of rails, ties and roadbed. Indeed one may go farther and contend that to let motor busses and motor trucks use highways kept up by the state at no expense to motor bus and truck companies, while the railroads must keep up their own roadbeds, discriminates unfairly against railroads. Such a policy might cause goods to be carried by motor truck which could more cheaply, except for the subsidy of a free road, be carried by rail, and this at the expense of the government, so that there would be an encouragement of economic waste. Something is to be said, therefore, perhaps, for the gasoline tax. *But nothing is to be said for using such a tax as an excuse to let private landowners keep in their own pockets a situation rent which the growth and development of the community and perhaps the very highways built by the gasoline tax, have produced.* Such rents should go, practically entirely, to the community, in any case, even if the revenue so secured is to be supplemented by other taxes.

*lying alongside of and close to these highways, while the land of the farmer remote from these new roads remains cheap or grows even cheaper. Yet he, too, though his land, apart from the improvements on it, may be worth next to nothing, so that if only land values and not improvements were taxed his burden would be almost nothing,* shares, often, the prevailing prejudices of the owners of more valuable land. And so, as he drives his old Ford car over the poor roads near his

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As things are, the gasoline tax certainly does *not* rest on the public in proportion to road benefit received. It must be paid equally by the farmer located on a mud road far from the concrete ribbons on which he can seldom drive his car, by the city mechanic who perhaps uses mainly city streets paid for from other funds, and by the person past whose property the concrete roads are constructed to his great convenience and profit. As a result of the construction of the roads some people find their site values greatly enhanced while others find their relative isolation harder to bear than before.

Since the days of the old toll roads, there has been, until the motor car era, construction and repair of streets and roads by special assessments or out of general tax funds, and there has been free use of the roads by drivers. Perhaps such free use is still to be preferred. If it is desired to make heavy motor busses and motor trucks, which are directly competitive with the railroads, pay for the wear and tear they are responsible for on the roads they use, this might be done by some special form of tax or fee designed for that purpose.

With that possible exception, perhaps the ideal solution is to use for street and road building, which subsidizes travel, as well as for public schools, which subsidize education, and for the maintenance of courts, police force and other governmental services important for us all, funds raised by taxes drawn chiefly from the rental value of land. At any rate, a system which permits the *private* enjoyment of values which are *almost entirely a community product*, cannot be defended as an ideal permanent solution of our tax problem.

own farm, with taxed gasoline which is helping to concrete the highways elsewhere, raise the land values of others by far more than the gasoline taxes *they* pay, and create an aristocracy of well-to-do landed proprietors, into the ranks of which he, like the laboring man of the city, has small chance to enter, he is as likely as not to echo their sentiment in favor of "tax relief for real estate!" Thus there is wide support for a system of gasoline taxes which, *relieving* land, makes the many contribute to road improvements from which *a comparatively few derive privileged returns in the form of higher value for their land.*

What influences are back of demands for "relief" of farmers from taxation when the policies advocated *definitely burden tenant farmers and farm laborers and make the rise to the position of independent owners as difficult for them as possible.* What influences are supporting such demands when a tax system which would relieve those isolated farm owners who most need relief and which would, at the same time, favor the chances of tenant farmers to become independent owners, is *studiously ignored?* It would seem that many of the so-called spokesmen of the farmers, who are the loudest in calling for farm "relief", are definitely *the enemies of tenant farmers and farm laborers* as well as of the poor of the cities!

Even as this chapter is being written, the news comes<sup>20</sup> that Senator Thomas P. Gunning has proposed in the Illinois State Senate a bill of the Illinois Municipal League, which would authorize cities, villages and incorporated towns to adopt and enforce ordinances for municipal income taxes and municipal sales taxes. Doubtless the partial substitution of such taxes, in local *as well as* state taxation, will be widely hailed as an advance! Certainly one would expect speculative holders of vacant land to welcome it and the resulting high land prices which make home ownership expensive!

Is sane reform, then, hopeless? Has our economic system become so complicated that the common man cannot hope to understand it even in its major outlines and must be the easy prey of plausible but specious arguments set forth by interested parties? Does the large amount of stocks, bonds, mortgages and other intangibles constitute a confusion from which he cannot hope to extricate himself into a clear comprehension of the real relationships of property, income and deserving contribution? Are his children doomed to hopeless tenancy and possible ultimate serfdom because he cannot understand that untaxing land raises its value and that *high land values are a curse* and not a

<sup>20</sup>St. Louis Post-Dispatch, December 2, 1931.

blessing,—because he accepts uncritically from real estate owners and government commissions the idea that it is a *good* thing to raise land values by untaxing land?

I confess that I have little confidence in many of the persons who talk most glibly about the great "promise" of the "social sciences" in guiding human affairs. I still recall a talk made by a very prominent public man, formerly the governor of an important state, before a meeting of one of the social science groups, in which this man thus paid his respects to the social studies. Yet within a very few years this same man was urging tax "relief" for real estate and with no distinction between site values and improvement values.

The truth is that the accumulation of masses of statistics and numerous minutiae about human relations, in the absence of a clear comprehension of basic principles, *is only pseudo-science*. The persistent ignoring, by persons who claim to be interested in social studies, of the significance of the fact that most people have to pay a comparatively few for the privilege of living and working on those parts of the earth where life is reasonably possible and work reasonably effective, is a silent confession that these students of "social science" are not going to discover anything very fundamental or anything

the discovery of which might cause them to lose caste among those who live on the work of others.

### §5

#### *Taxation and Some Problems of the Modern City*

“The advantages of raising public revenues by taxing community-produced site values rather than by penalizing industry and thrift are, clearly, not confined to cities. Nevertheless, an appreciation of these advantages will perhaps be etched most sharply on the reader’s mind if, in concluding our discussion, we pass in review, briefly, certain salient characteristics and problems of the modern city and of modern city life.” And in doing so we shall make sufficiently obvious how utterly ridiculous is the notion of some economists that land-value taxation is a significant reform, if at all, only for an *agrarian* state!

“The city is a much larger part of the economic life of the modern world than it was of the economic life of the world of the ancients or of the middle ages. To begin with, it is a trade center. That, the city has been always, but never before have the efficiency and cheapness of transportation made this function so important. Great fleets of passenger and freight trains rush daily into and out of magnificent passenger stations

and large freight depots, coming from places hundreds and thousands of miles distant and from many directions. Concrete roads, gray ribbons stretched across the fields and through the woods of the countryside, converge on the city. From all parts of the sea-faring world, if the city is a seaport, come giant ships to cast anchor in its harbor. The products of distant mines, plantations and factories pass through on their way to far markets and are, in part, intercepted and used by the city's people. Many of these products are raw materials which must be manufactured and sent out again in finished form for sale to widely scattered consumers. Trade, indeed, is ancient, but trade on the contemporary scale is wholly modern.

"The location of the city is partly a matter of position in relation to the surrounding territory to be served. The city may be as the hub of a wheel of which roads and railroads are the spokes. Its location may be dictated in part by the results of physical forces which operated in remote geological ages. Ships must dock and land their cargoes where a harbor is. Railroads must focus where ships come in. Men must work where work is to be done. There must be men at the wharves, men at the railroad stations, men to build and to repair stores and factories and houses, men to operate trucks and taxis, men and

women to work in the factories and stores, men and women to sell to all these workers the food and clothing they need, the luxuries they desire and can afford. There must be insurance agents, bankers, ship brokers and men of numerous other occupations. In a single one of the towering buildings which make for the eyes of the approaching visitor a picturesquely jagged skyline there may be thousands of workers,—accountants, lawyers, investment bankers, brokers, and others.

“In the city is now done much of the work which, a few generations ago, was done in the country. Spinning and weaving are done in the factories, not in the home. Clothing is purchased ready-made. Food is canned largely in factories. Farm work which used to be done by hand or with simple tools inexpensive to make and to buy is now done with the aid of expensive machinery made in the city. Proportionally less labor, and so less of the population, is needed on the farms. Competition forces down, relatively, the remuneration of farming and tends to drive the excess farm labor supply to the cities, where there is the lure of apparently much higher wages,—the evils of city life for the poor not being clearly visualized.

“For all these reasons the city draws its millions to do the work which can be done adequate-



ly nowhere else. And here their work is effective, aided by every device that inventors can plan and by the workers' nearness to each other and their high degree of specialization.

"But because the work must be done here and because the workers who do it must live here, those who are permitted to claim this part of the surface of the earth as their own reap rich returns. Men must pay them for the privilege of working in this area, must pay them for the privilege of living on this part of the earth. And because, as the city grows, this land becomes more and more valuable, there are persons who buy land and hold it vacant waiting for it to rise in value that they may sell it at a profit. Thus is land made still more expensive. Thus are the poor compelled to live in even smaller quarters. Thus is home ownership made, for the masses, a yet more impossible ambition. Land becomes so expensive that the people of the city, even in their corporate capacity, feel that they cannot afford to buy sufficient space for parks and playgrounds and school athletic grounds, since the city must pay private owners *for the very values that the city itself creates*. And so the children whom high land values have crowded in their homes are, from the same cause, denied relief outside.

"In this situation, when privileged owners of

land are pocketing the rents which the growth and development of the city and its tributary territory, and *not any activities of their own*, have produced, when land rents, thus the result of general community development, are the highest they have ever anywhere been in the previous history of the world, we hear constant pleas that land should be *relieved* even of part of the taxes it now pays, and the burden put elsewhere. Such relief would but encourage speculation; it would leave yet more of community-produced value in the hands of privileged private owners, and it would make land still more expensive for the poor man's home.

“At the same time we hear men talking about rising land values as if such increase were to be desired. This seems to be the ordinary popular view, perhaps because the tone of opinion is set by speculators in land, while the masses of common folk, working for salaries and wages and living in hired apartments or tenements, are not directly and acutely conscious that *land* is something they have to pay for the privilege of using, *both* where they work and where they live.

✓ The truth is, as we have said before, that high sale values for land are, could these common folk only realize it, *an economic and a social calamity*. Who would boast of a high price, in his city, of bread or meat or clothing, as if that

were desirable for the people who must live there? Then why think of high land values, brought about by allowing private individuals to enjoy, and to capitalize into sale prices, and to speculate in, community-produced advantages, as desirable?

"For the highly-civilized countries with their efficient technology which transfers most production to towns and cities, the old days of life in the country are gone, so far as an increasing proportion of men and women and children are concerned,—gone perhaps never to return. The open fields and woods, horizons not shut from view by sky-scrapers and close-set dwellings, the healthful work of the out-of-doors—these are largely things of the past. Men must live close to their fellows; they must work in towering buildings, twenty, forty, sixty and more stories from the ground; they must rush in busses, surface cars, elevated trains and subways ✓ to their work in the morning and back to their homes at night, for the millions who work in a great metropolis cannot all live within a few blocks from where their work is to be done. Yet they must not live too far away. And so, land in the great cities and their suburbs comes to have a tremendous value, and speculators, holding part of it for higher prices, make it artificially scarce and still further increase this value.

Gardens and green grass and trees and play spaces are too seldom seen. For too many children there are, in place of the woods and fields, only the dingy and dirty and traffic-filled streets and the crowded city sidewalks. Yet childhood demands, and will have, its play. The instincts of the race cannot be entirely thwarted, however bad the environment in which they have to be expressed.

- ✓ “Some day there may come into existence the ideal city, what, from our present conservatively cruel point of view, may seem a dream city, although there are, even now, some remote approximations to it. In that city a tax will take for the benefit of all the people, all or nearly all the rental value of all the land. Improvements, brought into existence by the labor and thrift of individuals, will be exempt or nearly so. The necessities and amusements of the poor will not be taxed either directly or indirectly. No one will be able to afford to hold land out of use for speculation. Except for the tax, land will be costless, or nearly costless, for there will be no large privately-received site rent to capitalize into a gigantic sale price. And so the city government can afford, without risking bankruptcy, to fill the city with beautiful and spacious public buildings and with frequent playgrounds and parks. Then we shall have for all but, most im-

portantly, for the city's children, the best substitutes available for the life in the country and the country village, enjoyed by a majority of children in the generations which have passed. And these we shall have without sacrificing but, rather, while extending, those opportunities for education and culture which city life, whatever its evils, has tended to promote."

Tax relief for real estate? And with *no distinction* between improvement values and socially-produced site values! It is this which is being sought in many states, including my own, and with growing promise of success. Already a number of states have ceased to levy any taxes on land for state purposes. What do *you* think is likely to be the consequence to equality of opportunity and the future of American democracy? What shall be done about it?

I am not at all trying to stir sympathy for the person with a \$50,000 income who, because of a progressive income tax, must contribute heavily to the support of governmental functions. But I am contending that an income from property is to be distinguished from an income gained by labor. And I am also contending, most emphatically, that an income derived from capital which is brought into existence by work and saving and which adds to the wealth-producing efficiency of the community, is to be distinguished

sharply from income that an individual secures through being able to make others pay him for the privilege of living and working on the earth and for the enjoyment of community-produced advantages. Not to make these distinctions is to penalize efficiency in serving the community. Not to make them is to penalize thrift and the accumulation of capital. Not to make them is to leave to the owners of sites, even though income taxation be highly progressive, a large part of the community-produced rental value of land. Not to make them is to facilitate speculative holding of land. Not to make them is to leave the way clear for high salable value of land, with all the consequences of tenancy, inadequate playground space, and congestion, that such high salable value tends to bring about. Will it be some popular "man of the people" who will lead us to these results!