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## TAXATION OF UNEARNED INCREMENT IN GERMANY.

IT is a well-known fact that the taxation of the unearned increment of land was advocated, as a corollary of David Ricardo's Theory of Rent, by the two disciples of this theory, James Mill and John Stuart Mill. The former discussed the question in his *Elements of Political Economy* (1821). His son, who is the more widely read of the two to-day, worked out the idea in greater detail in his *Principles of Political Economy, with some of their applications to Social Philosophy* (1848). He says: "Suppose that there is a kind of income which constantly tends to increase, without any exertion or sacrifice on the part of the owners, constituting a class in the community whom the natural course of things progressively enriches consistently with complete passiveness on their own part. In such a case it would be no violation of the principles on which private property is grounded if the State should appropriate this increase of wealth, or part of it, as it arises. This would not properly be taking anything from anybody; it would merely be applying an accession of wealth, created by circumstances, to the benefit of society, instead of allowing it to become an unearned appendage to the riches of a particular class. Now this is actually the case with rent. The ordinary progress of a society which increases in wealth, is at all times tending to augment the incomes of landlords . . . they grow richer, as it were in their sleep, without working, risking, or economising." (Book V., Ch. 2., § 5.)

These words of John Stuart Mill's would appear to be directed against Ricardo himself. For the latter, in the Dissertation on Adam Smith (*Principles of Political Economy and Taxation*, third edition, 1821, Ch. 14), says: "The burdens of the State should be borne by all in proportion to their means; this is one of the four maxims mentioned by Adam Smith, which should govern all taxation. Rent often belongs to those who, after many years of toil, have realised their gains and expended their fortunes in the purchase of land or houses; and it certainly would

be an infringement of that principle, which should ever be held sacred, the security of property, to subject it to unequal taxation. It is to be lamented that the duty by stamps, with which the transfer of landed property is loaded, materially impedes the conveyance of it into those hands where it probably would be made most productive. And if it be considered that land, regarded as a fit subject for exclusive taxation, would not only be reduced in price, to compensate for the risk of that taxation, but in proportion to the indefinite nature and uncertain value of the risk, would become a fit subject for speculations, . . . it will appear probable that the hands into which land would in that case be most apt to fall, would be the hands of those who possess more of the qualities of the gambler than of the qualities of the sober-minded proprietor, who is likely to employ his land to the greatest advantage."

For a long time it seemed as if Ricardo's view would prevail. A special taxation of the "unearned increment" in the sense of John Stuart Mill has, however, always found a measure of support both among economists and among agitators. The work of Henry George, and his influence in stimulating and keeping alive the efforts and agitations in this direction in the United States of America, are well known. A similar movement appeared in other countries, and especially in Germany. Here, however, the agitation has been increasingly concerned with the phenomena of ground ownership in towns, especially in large towns, and with the rise in value of urban sites. And, which is of more consequence, the movement has, since the beginning of the present century, achieved some practical results.

## II.

The factors which have co-operated to produce this result are the rise of the German towns during the last decades, the general rise in material prosperity and in the capacity to contribute to the State Exchequer, and the enormous growth of the urban population. In 1905, forty-one German towns had a population of over 100,000; nineteen had more than 200,000 inhabitants, and 526 more than 10,000. Berlin with its suburbs has to-day a population of about three millions. Whereas in 1820 six-sevenths of the population of Prussia lived in towns of less than 3,000 inhabitants, or in the heart of the country. The total population of Germany increased from twenty-five to sixty-five millions between the years 1816 and 1910.

Further, it is admitted that urban building sites have, at any rate in a number of instances, exhibited the phenomenon of rising rents more clearly and unmistakably than agricultural land. These rises are very little influenced by the kind of improvement which does so much to increase the produce of the soil, and yet hampers rather than advances the increase of the ground rent (in Ricardo's sense). They are more regular, even if they fluctuate occasionally, so long as material prosperity increases and the growth of the population is not arrested. No such constant rise can be looked for in the case of agricultural rents; indeed, the experience of the last thirty or forty years has just shown how this rise can be arrested by the competition of the agricultural products of the world markets, *i.e.*, by the opening up of new countries, and by improved methods of transport.

The rise of urban rents has shown itself to be not only more regular, but greater and more rapid than that of agricultural rent. The Cities of London, Berlin, Paris, &c., furnish glaring examples. Hence the attraction for the legislator of a tax on "unearned increment" which shall meet the demands of justice towards the life of the community. We can only wonder that the demand was for so long confined to the domain of economic science and of popular agitation before the ice was broken, and the example of a few cities suddenly incited a larger number of others to follow in their wake.

The taxation of unearned increment began as a municipal, and not as a State enterprise. Just as in 1893 the Prussian legislature ceded the land tax and the house tax to the municipalities, and renounced all claims thereon for the State Exchequer, so in this case also the anterior claim of the municipality was acknowledged. The "increment" is very largely to be attributed to the expenditure of the towns on modern municipal institutions, on the schools, hospitals, streets, the sanitary improvements, drainage and lighting, whose cost has increased by leaps and bounds in the last decade. A portion of the "increment" should, therefore, be returned to the municipality, and even so, the compensation would be very inadequate if other forms of taxes and contributions were not used to supplement it. For the annual yield of the increment tax has been no more than about £3,000 in Cologne (1908) and Breslau (1907), towns with a population of over half a million.

To Frankfort-on-the-Maine belongs the credit of being the pioneer in this matter; an increment tax was here imposed in

1904. Cologne and Gelsenkirchen followed suit in 1905, Dortmund and Essen in 1906, and the tax eventually found its way into the budgets of about three hundred towns and a few rural municipalities.

A transfer tax (stamp duty) on the sales of land and buildings, which we may look upon as an embryo of the increment tax, preceded it by a short interval of time. We use the term embryo, not to imply that the yield is insignificant, for it is, on the contrary, rather considerable (between one and three per cent. of the purchase price, in addition to the old State-imposed duty of 1 per cent.), but because the older tax embodies the same purpose as the newer, in an undeveloped form. The transfer tax, too, though in a cruder fashion, is directed, or can only be reasonably directed, at the profit bound up with the purchase or sale. True, it is not clear in this case which of the two contracting parties, the seller or the buyer, is intended to pay the tax, and in actual practice the incidence varies. The increment tax proper is, so to speak, the flower which grows out of this blossom. Here, too, the ultimate incidence remains an open question, but the intention is clearly that the seller shall hand over a portion of the profit which he derives from the sale of his property.

It would take us too far from our main subject to enter here into the details of the municipal taxes above referred to. We therefore refer the reader to other sources of information on this topic,<sup>1</sup> and will now turn to the newest phase of the controversy, the Imperial increment tax of 1911.

### III.

One of the main disadvantages suffered by a federal, as contrasted with a single State, is the necessity that exists of raising the requisite funds for the union, as well as for each separate State. Not that the total financial burden is increased, but the same ground must, as it were, be covered twice. The German Empire would require precisely the same expenditure to meet the needs of the Army and Navy if it consisted of a single State. But the mere fact that two kinds of budgets, two different systems of taxation have to be devised, increases the difficulties which each financial administration already has to cope with. Add to which that the Empire has, in any case, the more difficult portion of the task. The expenditure on the Army and Navy, and the

<sup>1</sup> Cf. the periodical *Finanzarchiv* of the year 1908, and *Transactions of the Verein für Social Politik*, Vol. 127. Leipzig. 1910.

constant increase of this expenditure to keep pace with technical improvements, is in a measure tyrannical, it does not adapt itself as readily as other kinds of expenditure to the resources of the country. The Prussian State, moreover, enjoys a more comfortable financial position than the Empire, owing to its vast lucrative asset, the State-Railway system, which (exclusive of interest on the funded debt) contributes more than £10,000,000 to the State finances.

The consequence is that the Empire constantly needs new taxes, and that new forms of taxation are constantly being devised in the hope of increasing receipts. Several of these attempts have been barren of result; others have borne modest fruit, their yield being striking neither in degree nor kind; no signal success has been achieved. The chief obstacle has been the lack of a strong majority in the Reichstag, on which the Imperial Government might have relied for support.

Among the moderately successful experiments were the two financial enactments of 1905-6 and 1908-9. In both cases an effort was made to equalise the burden of taxation which had hitherto fallen most heavily on the masses. Indirect taxes on articles of daily use were supplemented by direct taxes which were aimed at the more well-to-do classes. Such equalisation of burdens had indeed been partially effected by the income tax levied in the separate States and in the municipalities. So urgent, however, has been the demand for increased receipts which every change was initiated to meet, that even the existing indirect taxes have not been stationary. A progressive rise of indirect taxation has proved unavoidable, and a further development of direct imposts seemed necessary to equalise the burden.

Taxes on income were already widely prevalent in the separate States and in the municipalities. Death duties, on the other hand, as regards the nearest degrees of relationship, that is, in the case of the great majority of bequests, were very little developed. Nothing could appear more appropriate than further development on these lines for the needs of the National Exchequer. Hitherto the selfishness of the propertied classes, and especially of the landowners, had frustrated all attempts of this kind in the Prussian Parliament, which rests on the three-class electoral system. It might have been hoped that in the Imperial Parliament, which is elected by equal universal suffrage, a majority should easily have been secured to carry through an adequate legacy duty, such as England, France, and a few of the smaller German States, *e.g.*, the Hanseatic Republics,

Hamburg, &c., already possess. Such a hope would have been doomed to disappointment, and might have taken its place in the history of unfulfilled expectations, side by side with the old belief that the democratic franchise of the French Republic must surely result in the imposition of an income tax. As a matter of fact, a proposal for the establishment of a legacy duty, introduced into the Reichstag in 1909, was rejected by the majority, and the statesman who had identified himself with the project was obliged to withdraw from the leadership of Imperial affairs.

The exigencies of party government resulted in the overthrow of Prince Bülow, the substitution of a scheme of Imperial taxation approved by the majority, for the rejected Bill, and the acceptance of this by the statesman who had so long stood at Prince Bülow's side in the administration of national affairs. Some of the provisions of the Act of 1909 are outside the scope of this article, which is concerned only with the tax to be levied on unearned increment. Owing to the difficulties involved by several provisions of the measure, it was adopted in principle only in 1909, subject to a more detailed elaboration which was submitted to the Imperial Parliament last year, and has only now (end of January, 1911) been passed into law.

#### IV.

One of the complications of the point at issue was the attitude taken up by the Imperial Treasury. The latter submitted to the Reichstag, on June 14th, 1909, a memorial containing a trenchant criticism of the projected Imperial increment tax. It was pointed out that the value of a piece of land was determined in the first place by local conditions, and that these conditions depended to a great extent on the exertions of the municipality within whose territory the land was situated. Hence it was just, that when the owner sold his land and obtained the cash equivalent of the increase in value, he should hand over a portion of this profit to the public body to whose activities he owed the enhanced value of his property. This public body was the municipal authority, more especially the urban municipal authority. The direct co-operation of the Empire in the matter was not so obvious, nor was it sufficiently frequent to constitute a claim to a share in the yield of this tax in all cases of a rise in value. The indirect influence of the Empire, moreover, was so remotely connected with the enhanced value, that it could

constitute no more than a secondary claim on the tax, and even this must be subject to the proviso that the acknowledged claims of the municipality in this respect were not allowed to suffer. An Imperial tax on increment, therefore, involved a considerable and unequal encroachment on the domain of local finance. The difficulties which beset the choice of a suitable form of tax were even greater. Like all questions affecting land, its taxation was indissolubly connected with local peculiarities. These were so varied that even fundamental principles could hardly be laid down in a uniform and appropriate manner for the whole Empire. Nevertheless uniform provisions for the imposition and collection of the tax were essential for an Imperial duty, if a financial yield were to be secured to the Empire at all. Moreover, such experience as was available of this new kind of tax was as yet much too slight; the existing conditions of its local working were purely experimental, intended to provide, in accordance with experience, the requisite groundwork for a suitable development of the tax. Many years would be required for the fulfilment of this purpose, at all events for so far-reaching a measure as an Imperial duty. The nature of the unearned increment was so problematical, that out of the consideration of a great number of attempts instituted by the municipalities, only a very small kernel of information could be extracted. And this entailed patience, more time, and a multiplicity of local experiments.

In spite of all these objections urged by the memorial, the majority of the Reichstag decided on July 10th, 1909, that an Imperial tax on the unearned increment of land should be introduced no later than April 1st, 1912, and should be so imposed as to give an annual yield of at least £1,000,000. A sketch of this law was submitted to the Imperial Parliament by the Chancellor on April 11th, 1910. The first reading, which took place on April 15th, 1910, resulted in the reference of the scheme to a Commission of twenty-eight members, from which, towards the end of the year 1910, it reached the Reichstag, amended in detail, but in all essentials in agreement with the Government scheme. The justification which the Government offered for the scheme was a slight one, and appears all the more so in view of the fact that the Government had now dropped all the objections which it had so recently urged. The explanation is not far to seek. There was no anxiety at headquarters on the score of the necessary support, since it was the majority itself which had demanded such a scheme, and had accepted the responsibility for a law, the grounds for which were too weak to admit of a good defence.



As frequently happens, attempts were not wanting to fill up the gaps in the justification of the step taken, by gibes at the "theories" of the learned. Because it had been found impossible to work out satisfactorily the principles underlying this tax; because an adventurous law had been passed in hot haste; because a superficial measure, whose success in practice was by no means assured, had been introduced by the Imperial Government, it became convenient to repudiate the economic principles on which alone this and all sound taxation should be based. Thus, at the first reading in the Reichstag, the Secretary of the Treasury said: "We have long since advanced beyond the theory of John Stuart Mill, which underlies the taxation of the unearned increment. We have long since reached the solid ground of practice(!), and we have also travelled far beyond the cool, critical, sceptical memorial, which we ourselves submitted to you on June 14th, 1909. The standpoint which the memorial took is now no longer tenable(!). For ripeness threatens to pass into over-ripeness, and if we do not pluck the fruit soon, we run the risk of finding it unfit for consumption." A singular justification this. It seeks to extricate the Government from an awkward situation, by transmuting the inconsistency between contradictions into an adventurous sacrifice of the reasonable objections recently urged against a law. For now the very same law had to find its justification on unreasonable grounds, or, indeed, on no grounds at all. Reasonable grounds for a law are never over-ripe; the lapse of time only adds to their urgency.

## V.

The passage through the Reichstag of the new law was facilitated by the attitude, not only of the existing majority (the Right and the Centre, which at present support the Government), but also of a small portion of the Left, which in other matters constitutes the Opposition. And it was partly the Imperial character of the tax, to which we have taken exception, that was responsible for its success. For an increment tax in the abstract naturally finds supporters in the Liberal and Radical ranks, and sweeping measures commend themselves most favourably to the radicalism of supporters of this type. Their impatient zeal is most rapidly appeased by a wide general measure for the Empire—it would not suit them nearly so well to wait patiently while year by year a number of towns proceed to imitate their predecessors in this respect. The Radical attitude

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would be justifiable enough if the principle in question were universally admissible, tested by experience, and capable of being worked out in detail on approved lines. This, however, is by no means the case. The experiment of the local administrative authorities has been transplanted bodily into Imperial affairs, and in all probability it will be found necessary, after many varied and instructive experiences, to undertake a great revision of the Act of 1911. In the meantime the complications of the problems to be solved will cause a great deal of trouble.

We may here refer to a work which brings out these difficulties in a striking manner.<sup>1</sup> The author is President of the highest judicial tribunal to which lawsuits on questions of increment tax are referred, and speaks from experience. For even in the case of the existing municipal taxation, the provisions with regard to the estimation of the value of improvements occasion great difficulties to the tribunal. And yet the taxes are levied almost exclusively by municipalities, where the land consists of urban sites which change hands very frequently and the assessment is not made to depend on nearly so many conditions as the new Imperial law will insist on. Whether the improvement under consideration is a lasting and "extraordinary" one; whether it will be followed by a further rise in value; whether it is merely a question of the restoration of a building or apparatus already in existence at the time of the original acquisition of the site, or whether there has been a new building—these are but a few of the points which will occasion a mass of new and tedious controversies, and litigation in urban and eventually in agricultural districts. Further, in agricultural property the line of demarcation between improvements on the one hand, and necessary upkeep and adequate cultivation on the other, is much less rigid than it is in the case of house property and building sites. The boundary between ordinary trade expenditure and the cost of improvements is difficult enough to define for the purposes of the income tax which is assessed afresh every year. But these difficulties sink into insignificance in comparison with the task of going back—in the absence of all written records—over a past of forty years. The small owner will be the least capable of furnishing the requisite evidence for arriving at the cost of the investments which must be deducted from the selling-price of the land. Such considerations might justify a rather wider

<sup>1</sup> "Betrachtungen zur Reichszuwachsststeuer," by Dr. Jur. Strutz. Berlin, 1910. The author is president of one of the Departments of the "Oberverwaltungsgericht" of Prussia.

latitude in dealing with agricultural, and especially with peasant properties, than in the case of urban sites. But this is a general statement difficult of application in practice. And however and wherever the boundary line between the two may be drawn, the tax would inevitably tend to become an even more disproportionate burden on the towns than it already is, and in conjunction with the other new Imperial taxes would become a mere caricature of a system of general taxation of the propertied classes in accordance with their ability to pay. It is impossible to fit such heterogeneous elements as urban house and ground property on the one hand, and agricultural land on the other, into a common mould for the purposes of taxation, especially when the mould is really suitable for the former class alone. Such an attempt can only lead to injustice and discrepancies.

Even if it were possible to solve for the moment the innumerable difficulties of fundamental importance, within the compass of a single measure, speculators in land sites would constantly devise new methods of evading the tax. This much is shown by the municipal taxes, which exhibit a permanent struggle against constantly renewed attempts at evasion, hence a continual race, so to speak, between those who impose and those who are liable to the tax, in which the former are always a length behind. Hence provisions which frequently require two, or even three, supplementary orders within a single year. An Imperial tax will be exposed to the same difficulties in an even greater degree. The machinery of imperial legislation works much more slowly and cumbrously than any other, and will be all the more easily outwitted by the cunning of those on whom the tax is intended to fall.

For the rest, it is evident that the new Imperial tax trenches on ground hitherto reserved to the municipalities for their exclusive use.<sup>1</sup> This cannot be a matter of complete indifference to the latter, in view of the large increase of their financial necessities. As early as 1905 it was seen that the taxation under all heads of the Prussian towns (exclusive of Berlin) had more than doubled within the previous ten years; the average per head had risen from  $16\frac{2}{3}$  to  $25\frac{1}{2}$  marks, *i.e.*, fully 250 per cent. of the State income and property tax. The greater part of this money is used to further the material and moral welfare of the population, and may be looked upon as a vital necessity.

<sup>1</sup> The yearly proceeds of the new tax are estimated to the amount of two Millions of Pounds Sterling, of which 50 per cent. to the Empire, 10 per cent. to the State, 40 per cent. to the Municipality; the State is entrusted with the levy of the tax.

How far can "experiment," which is so undoubtedly justified in the natural sciences, be resorted to in social and political questions? The point has given rise to much discussion, and grave doubts have been expressed with regard to the experiments even on animals. How much graver must be the doubt when human life is involved, unless indeed the experiment be quite harmless and for the benefit both of the individual and the community. It cannot be denied that many new measures, destined to serve both physical and moral ends, contain a large, unavoidable, experimental element. But it will always be essential to limit the experimental element in relation to the importance of the end to be achieved. A due proportion must be maintained between the measure of the irrational, the doubtful, the adventurous on the one hand, and the safe goal of the result to be obtained on the other. In the problem briefly discussed above, the experimental element is large enough, even within the domain of local taxation. Here the results to be achieved would have been sufficiently assured. The extension of the doubtful tax to the Empire has overstepped the limits of justifiable experiment, and has created a law which can only be described as adventurous.

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