
Land Policy, Land Taxation, & Economic Development

**A Report on Land Taxes of
The Republic of China (Taiwan)**

C. Lowell Harriss

LAND POLICY, LAND TAXATION, AND ECONOMIC DEVELOPMENT

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Land Policy, Land Taxation, and Economic Development

C. Lowell Harriss, Professor of Economics, Columbia University. A summary of portions of this study will be presented August 25, 1971, at Chengchi University. Views expressed are my own and not necessarily those of any organization with which I am associated. Funds from the John C. Lincoln Institute, University of Hartford, Connecticut and the Asia Foundation have helped to make this report possible. Taxation of rural land presents special aspects which are not covered here. Time limits have prevented the fuller discussion of many points as I should have liked.

Your economic progress reflects that fact that you have been doing many things very well indeed. The figures prove it. Our own eyes--those of you who are on the spot here and those foreigners who, like myself, have been privileged to visit more than once--ours eyes, reveal new and impressive achievements. And the future offers bright opportunity. The general level of economic well-being can continue to rise impressively. Projections for the next few years show substantial improvements in levels of living of a growing population.

To make the best of opportunities, modern man-- here, in America, everywhere--must deal wisely with the problems of land. And merely to keep some things from getting worse and thus nullifying part of the gains we shall work hard to get, land policies must be suitable. Poor land policies in urban areas will make, for ourselves and especially for our children, much poorer lives than will be possible, if land use follows good plans.

(I) Introduction: General Setting

Private Ownership of Urban Land: A Fact

Although Dr. Sun Yat-Sen may have favored very extensive governmental ownership of land, this condition does not now exist here. Nor are large enough funds likely to be available in the foreseeable future for Chinese governments--national, provincial, or local--to buy land other than as needed for high priority public uses. The realities, therefore call for tax and land-use policies which assume that private ownership will be the chief form.

From the point of view of capturing unearned increment, wide government ownership could be better--except that the amount of increment might be a good deal less. The "size of the pie" (the increment) to be shared does depend in part upon what

owners of land do, as well as upon the general trends of the economy. In a dynamic, progressive economy, such as on this Island, the opportunities for constructive, imaginative, creative uses of urban land will be very much greater than in more settled and stable economies. Could the procedures of governmental agencies, as they will actually exist, manage land as well as private owners? For the United States I am sure the answer would be "No".

Necessity of Limiting the Free Play of Private Ownership of Urban Land

What one person, or thousands, can do in daily life always depends in part upon how others use land they own. What one owner does with urban land has significance for others--nearby landowners, of course, but also persons as workers, shoppers, occupants of housing. Moreover, the usable value of a piece of land depends upon facilities provided, or not, by government such as streets, schools, water supply, sewers, parks, and so on. (Develop further if time permits).

These points are obvious. The reason for making them here is to help show why public policies which affect land, tax policies specifically, also affect other important aspects of urban life.

Taxes do not influence (except on a very small

scale) the amount of urban land in existence. Taxes on land do, however, influence the way the land which exists is used, or withheld from use. Moreover, the amount collected in land taxes makes a difference in the quantity and quality of governmental facilities and services which affect land values and the entire nature of the community.

The Reasons for Tax Revision

Consideration of any possible tax changes has meaning in light of goals to be advanced. A foreigner has difficulty in judging the goals of land tax policy which are most important for your society now. Ordinarily, and I believe such is true in your concern about land taxes, the objectives, the purposes, of any tax revision are numerous, but they usually fall into three broad groupings. (1) Revenues to pay for governmental services; almost always, expenditure pressures are so great that more revenues are a major reason for tax revision. (2) One or more economic and social purposes other than revenue may be prominent. Certainly, progress as envisaged from points of view other than revenue should be assisted where possible--as in better land use--and obstructed as little as possible. Taxes in producing revenue will inevitably influence the way individuals and businesses carry on their affairs. Some of these

influences are undesirable. Hopefully, tax reform can reduce these bad effects. (3) Greater fairness in sharing the cost of government--more equity (or less inequity) in taxation--ought to result.

Each of the three broad goals just listed can, I believe, be advanced by greater use here of urban land values as a source of revenue. And revisions of the present system can make it operate more effectively. The actual results will depend upon the specific features of the various taxes applying to land and to other property as these taxes actually operate in the "real world" of actual administration. The most fruitful tax reform will be that which recognized such realities as the willingness of taxpayers to make great efforts to escape high tax rates.

Principles (Criteria) for Judging a Tax and a Tax System

Time limits have not permitted me to summarize the various criteria which apply to comparisons of revenue sources. Several aspects, however, are dealt with to some extent at various points below and in the appendices.

Features of the Present System of Land Taxation in Taiwan

The present system of taxing urban land--and

taxing building and transfers of property--has several unique features (compared with what I have found in other parts of the world). There is much of exceptional value. The ingenuity, the aspirations, and the public spirit which created the present system would, I feel sure, welcome efforts to continue to improve. In a changing economy there will be opportunity to adapt to new conditions of the present and, especially, for serving in the future. The actual results during the years of operation can help to guide further development.

To identify some of the features which deserve note (as compared with what other countries do), one can cite:

- (1) the separation of land and structure so that taxes can be adapted to the factors which make land an outstandingly suitable basis for revenue to finance government;
- (2) the land value increment (LVIT);
- (3) progressive rates of land value tax (LVT);
- (4) progressive rates of land value increment tax with top rates which are very high;
- (5) rates of land value tax which are not subject to change by the units of government getting the revenue, as might be desired to meet changing revenue needs;

- (6) rates of house (building) tax which provide little scope for adjustment (in the light of revenue needs);
- (7) deed tax with rates which are high as falling on transfers of capital (not annual income);
- (8) different principles applied to rural and urban land;
- (9) owner "participation", to some extent, in valuation for tax purposes;
- (10) possibility of government purchase at prices related to value for taxation;
- (11) the adjustment of starting points for progression of LVT;
- (12) a carefully designed system of valuation.

Some of these features, and others, seem to me well suited to the long-run interests of the society. Others may, or may not, be desirable. Some, I believe, will actually impede economic and social progress. Therefore, a crucially important point needs to be stated without delay.

Directing Incentives Most Productively

Tax policy, land policy, and policies for economic development ought to be made in light of what human beings want (and dislike). People do respond to incentives. Positive incentives and negative ones--taxes, for example--influences will vary with the

intensity the height, of the tax rate

The desire to pay less rather than more in taxes is, I believe, universal. A fundamental consideration in making tax policy is that the people who will be called upon to pay will look for ways (legal and illegal) to escape tax. Moderate rates of tax will not give rise to strong inducements. But high rates of tax, and big differences in rates, will create large incentives.

Tax rates as high as 40 or 50 percent must exert great force. Rates of 70 or 80 or 90 percent will often be of dominating consideration. They can outweigh other factors. Such rates will tend to be the determining, compelling, aspects of taxpayer decisions. An individual acting for himself or his family, or a business manager for his company, will let tax consequences carry great weight. They can overshadow the inherent economic consideration which really reflect the opportunities of efficient and productive choice. Such responses are human. Government treasuries would benefit if men were more willing to pay taxes rather than trying to escape them. But few of us are made with such attitudes when government insists upon taking the lion's share.

Tax policy, therefore, should take careful account of the incentives created. High tax rates create

obstacles for the treasury. The higher the tax rates, the greater the obstacles which the tax administration must overcome. Differences in rates also create difficulties for those who are expected to collect revenue.

To repeat, a government in imposing high tax rates, and large differences in rates (as in a progressive rate schedule), thereby creates forces which are in opposition to itself. The higher the tax rate, the more that human motivations will be directed against the government (in its capacity as ~~tax~~ collector).

Specifically, the highest rates of the LVY, LVIT, and the deeds tax, are certain to have effects which are adverse to the objectives which are presumably to be served. But the magnitudes do differ considerably.

(See Appendix on "excess burden".)

(II) Land Taxation: Economic Fundamentals

The basic economic principles which support land taxation include somewhat more than may be understood from the term "unearned increment". Even if land prices are stable and give no indication of rising, they will be a good base for getting revenue to finance government. Focus on the earned increment aspect can lead to overlooking others.

Judging by the generally accepted standards for judging a source of government revenue the tax on pure land (location) value can be one of the best. And it can do more of advantage than produce revenues. It can also exert pressures for better use of land than if the tax were lower or not imposed.

Land Price as Related to Tax: Summary of Capitalization

In Taiwan there is distress about high prices of urban land. Although I am told, some people believe that land taxes raise the price of land, just the opposite is the case. The increment tax by discouraging sale of land in some may tend to raise prices, but the more general results of land taxation are to reduce the price of land. The basis principle of determination of land price is summarized in the formula.

$$\text{Land Price} = \frac{\text{Expected net annual income on assets of comparable quality.}}{\text{Rate of interest}}$$

If the annual net income expected is 1,000 and the rate of interest is 10%, then the price will be 10,000. Such a sum invested in the land will bring a yield equal to that obtainable elsewhere (on the assumption of a 10% rate of interest). Now assume that the annual tax goes up by 100 so that the net

income falls to 900. A potential buyer who can get a yield of 10% on assets will now pay only 9,000 for this land.

The 100 tax increase has been capitalized into a 1,000 drop in the price of the land. We return to this point later.

Land Values a Desirable Source of Revenue:

Preliminary Statement

(Urban) land values are one of the very best sources of revenue, especially for those units of government which provide local facilities and services. This conclusion was reached, in general principle, by economists many generations ago (in England, France, the United States, and probably elsewhere). Governments, however, made rather little use of what was the potential. (British India did accomplish a considerable amount in rural taxation in the 19th century). Use in much of the United States was probably greater than elsewhere. Even our system, however, has not relied so heavily on land values to pay the costs of government as would have been wise. To think of the lost opportunities saddens. Recently in the United States there has grown up more awareness of the possibilities. Scholars studying taxation find themselves in expanding agreement that high and rising land values

ought to be used much more to finance the expenses of government, especially local government. In the United States it is local government which pays for much of the facilities and services which directly affect land values. (In Taiwan, also, the revenues from urban land taxes go chiefly to units of government which provide services "close to the (urban) land".)

Land Values as a Product of Nature and of the General Development of the Economy

On fundamental point in making tax policy is look to the effects of alternative tax measures upon the creation of income. How can the inevitably harmful effects of taxes on production be kept to a minimum? In this respect we find one of the overwhelmingly outstanding reasons for taxing land.

Land as a productive resource differs in crucial respects from labor and capital. Labor is human effort. Capital goods--machines, housing, and so on--are man made. The quantity and quality of training, the vigor of human endeavor, the amount of machinery and structures, all these depend to a very large extent upon what individuals expect to get in compensation--the incentives. To bring such productive capacity into existence, society (consumers) must pay. And if government tries to take through

taxes much of the rewards for the services of capital (that is, take in taxes much of what customers pay), the future supply of capital goods will suffer.

Not so land. Nature created it in the physical sense. And society has created much of the demand that makes many locations highly desirable. Tax land heavily--it will not cease to exist or take a vacation or move elsewhere. This basic fact has more and more importance as the high costs of government invite tax rates on capital, earnings, and consumption which will have a variety of bad effects.

In its basic sense, the amount of land in existence will depend scarcely at all upon the amount that is paid to buy or to use it. The payment made for the use of land, however, does make a difference in the actual availability of any particular parcel, and in the use to be made of various plots of ground. Holding land essentially vacant, or in a use much below its full potential, may seem attractive to the owner as a speculation. If out-of-pocket costs do not compel much use of cash, and if there is a belief that the price will go up, an owner may wisely hold land in a form of low yield. (To commit it to a use with better income now, perhaps with a buildings, will hamper the freedom to sell or try in some other way to get better terms later). Society, however, loses the benefits

that would come from the fuller use now of the land's potential. Vacant and underutilized land are of concern in urban areas of Taiwan.

Parcels of land vary greatly--especially in their characteristics of location. Therefore, some system to help get most efficient use of various pieces of land is of utmost importance. The economy needs a system of inducements so that the different plots of land can serve most effectively. The allocation of land among alternative uses will depend upon the net amount (after tax and other costs) that the owner expects to get from the various possible uses. Payments for the use of land do perform this function, a function which is one of outstanding significance. (I return to this point soon).

One Thing not Changed by High Tax and Land--The Quantity

One result of a high tax (which is in force for long) will be to reduce the quantity of the thing taxed--with one exception, a high tax on land. Nature made land (in its original state) and has not charged for it. For the most part, land as space or location value (the chief element in urban areas) has not come into existence because someone paid to get it produced. Yet users sometimes pay a very high price (to buy or as an annual rental). When we do so, the forces which

created the land do not receive the generous payments.

Perhaps the person who gets the payment, and prior owners through history, will have invested money and effort in the parcel and in the neighborhood. (Dr. Sun Yat-Sen called attention to this fact, thus in effect alerting us against oversimplification). In such cases, something of what present users pay will represent compensation for such investment of capital. Most urban land, however, brings prices which are vastly greater than the worth of what the past and present owners have done to improve the location.

The amount which Taiwan's urban populations pay now, whether capital value or annual rental, will exceed by a large amount whatever was needed to get the land in its present state. What city today has more land (within the same boundaries) because the average price which people must pay is many times the payment 15 or 10 or even 5 years ago? If more of the payments for land had been channeled into the government treasury, the land as space would still be here. Land prices would be much lower.

For land--and land only--price does not in general have much effect in causing the production of the productive resources. (without trying to debate terms, we should be clear that the charge on land, such as "special assessment", which finance streets, sewers,

and other public facilities do help to create value). One of the basic functions of prices in an economic system is to induce the production of goods and services--but not land.

The Economic Functions of Price: Importance of a Good Market in Land

Price, however, does have an importance economic function other than getting things produced. That other function consists of guiding use, (1) of preventing waste in consumption and (2) of allocating resources in production according to their relative productivities and scarcities. A "high" price for some land is essential for guiding it to the best available uses.

A good market in land is of the utmost importance in getting the most productive use of something we must all have, space. A good market means one in which potential buyers and sellers (and owners and renters) have freedom to act on the basis of good information. Subject to rules of zoning, land-planning, and any other controls which reflect community interests. Buyers and sellers must be able to take account of all factors which affect the possible uses of each piece of land. Their decisions should not be influenced by factors which are unrelated to the uses of the plot.

The LVIT, however, is a factor which is relevant

for the potential seller. If he sells, he must give up, perhaps, 30% of the value of the land. Yet this 30% has not true and systematic relation to the productivity of the particular piece of land (location). Of plots of land which are side by side and essentially similar in economic productivity and worth 100, one owner selling might be left after LVIT with 100 (because the land was purchased recently), another with 70, another with 50.

In this respect the LVIT makes for a less effective market in land. The deeds tax also has this result; a burden of $7\frac{1}{2}\%$ on sale price does influence the alternatives open to buyer and seller but without any relation to costs of government associated with the transaction or any benefits. A local government has no need to spend more if a piece of property is sold. Neither buyer nor seller enjoys more or better benefits from government service if a deeds tax is paid. The tax will have some bad effects on the market in real estate. In contrast, an annual tax on land value (at a uniform rate) will generally tend to make for a better by discouraging underutilization.

Space limits do not permit an adequate discussion of the vital importance of a good market in urban land--or of the enormously difficult obstacles. The fact that land has buildings of widely different value

affects transactions. So do the uses being made, and contemplated, on neighboring plots. So does the state of urban land-use planning. And so do purely speculative factors.

Economic Nature of Tax and Land

The house (buildings) tax falls on capital values and in some degree is a burden on owners (suppliers) of capital. It is also to some extent a tax on income (as when owners of property rented are not able to shift the tax fully to the user), on consumption because the cost of housing and other things includes this tax, and on the processes of production. This tax is a burden in the basic economic sense. It does affect the amounts which will be produced and consumed.

The buildings and deeds taxes fall partly on business property. Presumably, therefore, as part of the cost of business operations they become part of the price of outputs of goods and services. To some extent they are a largely hidden, and a diffused, tax on consumption, including exports.

The land value tax, however, has economic characteristics which are essentially different from those of other taxes. Much of the LVT is not really a burden on the present occupant or user. The amount of tax which was in effect at time of purchase

would have been taken into account by the buyer. It would have been "capitalized" so that the price paid was lower. This process is explained later. For persons not familiar with the economic analysis please accept my assurance that this principle is accepted by economists without any exception so far as I know. It follows from the fact that the tax does not affect the quantity of land in existence.

Another general point bears directly upon land tax policies here. The appendix which discusses three bases for taxation--income, consumption, and wealth--deals in more general terms with reasons for keeping these distinctions in mind. Moreover, we should remember that taxes fall on people, not on things. The financing of government involves, always, questions about how costs are to be shared among people.

The land value tax, like property taxes in the United States and everywhere else known to me, is not a tax on net wealth in any meaningful sense. Almost never is there deduction for debt, and on urban land, debt is often a significant amount, perhaps much over half. (True in Taiwan?) More bonds, stocks, other securities, and deposits in financial institutions are excluded from the base or property taxes in other countries, and properly so,

because such assets represent claims rather than the things themselves. To tax tangible things and then the intangibles of ownership and debt would be to impose multiple burdens in an irrational manner. Efforts in the United States have failed, and for reasons which grow out of powerful economic (and political) forces--the resistances to economically unsound taxes. Although some governments in Europe do attempt to tax personal net worth, the principles are very different from those which underlie land taxation. The progressive features of LVT and LVIT do not relate to a meaningful total of wealth.

Nor is a land tax correctly thought of as an income tax as that term is ordinarily used. Although payment of tax comes out of income from some source, the tax base is an estimate of the capital value of land; the tax base is not income as it is actually received. Generally, of course, the capital value of a piece of land does relate to income; but when land is underutilized, the income that ought to be used for determining assessment is not the actual, but the potential, income. Attempts to base assessments on actual income (somewhat the practice in parts of the British Commonwealth) will distort the tax when land is used in ways that are not the best possible--or when held vacant for speculation. The methods of

valuation used in Taiwan try to avoid this defect.

To repeat a point which may be hard to see but which is economically true: In a meaningful sense, all or much of the tax on land is no current burden on the present owner or user. The tax rates have been largely fixed for many years. To the extent that the tax is one on land values that have existed some time, many present owners must have allowed for the tax in the price they paid. The annual payment is no true burden on the user. In other words, this part of what an owner pays over to the government each year does not really leave him worse off, compared with what would have been his situation if the tax has not applied when he bought the property. To the extent that land prices have risen since the owner purchased the land, the higher tax takes a part of the increment of value.

Economic Advantages of Taxing Increments of Land Value

One reason for urging greater use of taxes on urban land values to pay for public services seems to be widely understood in Taiwan. It was emphasized by Dr. Sun Yat-Sen. Much of these values are created by society. He pointed out, "the increase in land values is due to improvements made by society and to the progress of industry and com-

merce". (P.178) He emphasized the distinction between "bare land" and those plots whose present values reflect in part the expenditure of capital and labor on improvements. And, of course, many costs incurred by the community do affect the desirability of locations of land.

The tax as it can be applied thus ranks high on grounds of fairness. The general economic effects in terms of incentives for better allocation of resources are also better than for taxes generally. And, as we have seen, the quantity will not be affected because, for the most part, payments for land use to not, as do payments for man-made productive capacity, also perform the economic function of inducing the creation of the productive resource.

The amount paid in taxes can influence the growth in community facilities and governmental services and thus the worth of land. People expect governmental spending on streets, schools, water and sewage systems, police and fire stations, parks, libraries, and other governmental facilities. Or the private developer of a new area provides such facilities and includes the costs in the land price. In an urban area today, some part of what the buyer pays for land often goes to cover inputs of

capital by a private developer (True in Taiwan?) or government.

As public funds pour into governmental investments, and as population grows and incomes rise, land prices go up. And, of course, a speculative element can speed and add to the process of price increase--and also distort the relations of land prices. (Apparently land price increases in the urban areas of Taiwan have often jumped far ahead of values based on near-term uses). If a bigger fraction of the price rises were used for the financing of government, faster development of governmental infrastructure would be possible. In view of the need in Taiwan for such facilities, as well as for current services of education and other functions, more use of this potential source of revenue appears to me to deserve support. More of the annual flow of benefits from land could be taken (through LVT) to pay for current expenses of government.

As one contemplates the outlook for growth of the economy, what can we expect to happen to land prices in ten, twenty, and fifty years? Will they not generally be higher than today? So it would seem. Here is a most promising base for taxation. Land values have risen tremendously in some parts of the Island. There is firm reason to believe that over time there

will be further increases. Though the rises of recent years undoubtedly reflect much anticipation of the future, and have discounted a great deal of the near-term expansion, long years of growth must lie ahead.

If a larger fraction of the value changes of the last fifteen years or so had gone to finance government facilities and services, Taiwan would now have the same land but better infrastructure or better services. The past cannot be done over, but its lessons can help in tax decisions for the future.

The land value increment tax recognizes the uniqueness of land. It captures some of the past increase in land prices. Even larger revenue might be feasible from raising the starting rate, but this approach has the defect noted elsewhere. It discourages sale. The market in land, a resource of great importance, becomes less active and less free to reflect the changing conditions of underlying, true, demand and supply. Another effort seems to me to be worth considering as a way to reach changes in land values over the longer run - a higher annual tax. Today's opportunity in improving land taxation is not by any means limited to the LVIT to capture future increments.

Financing government, however, is not the only

part of the problem. Land use is another. Man has as yet found no close substitute for price as an allocating mechanism, but in the case of land other influences must also operate. Land-use planning, zoning, and other controls in the public interest are essential. The latter can make a world of difference in the quality of cities. The results of these various controls will, of course, be reflected in land prices; but land prices cannot possibly accomplish the planning function in the absence of direction from a planning authority. A few efforts--Great Britain and some cities of South Africa--have been made to tax especially the economic benefit resulting from favorable decisions about permitted land use. On the basis of my studies of such cases, I should not consider them even a small fraction as desirable as your LVIT. (How do land valuations here allow for changes in land use, building authorizations, and any other governmentally influenced efforts on land prices?)

Land Tax as Affecting the Use of Land but not the Quantity

Let me restate: What he pay out as more for some plots than for other has a purpose which is somewhat different than other prices. For things other than land, "higher" price not only affects use -

guiding, allocating, apportioning. Price also encourages and pays for more (or less) new output. But not so for land. To assure efficient allocation of land, the user must pay; but the owner need not receive all that is paid. Therefore, government can step in and take quite a portion of what the user pays, with no harm to the supply (the "output") of land nor to the pressures and incentives for efficiency in use.

But if society wants the best results, government must not try to take all (nor even the lion's share). An owner must feel confidence that his skill and effort in finding a use which will yield more return will bring him benefit. Moreover, as a practical matter ample room should be left for rewarding investment in land and in the development of value of location. (Valuation for tax purposes will not always be able to separate out such elements of value to tax them differently from pure unearned increments).

The (1) way that urban land is taxed, the structure and features of the tax, and (2) the amount of revenue collected will affect the growth and the nature of cities (in ways beyond the spending of the tax revenue).

In general, the chief function of taxes is to raise revenue so that government can serve the public.

But any tax which is important enough to raise significant revenue will have other effects on the way that individuals and businesses arrange their affairs.

No one I know likes to pay taxes. Yet for each person the quantity of governmental services received will not be smaller if he pays less rather than more tax. The same applies to business companies. For the public as a whole the amount paid in taxes most certainly does affect the quantity of services from governmental spending. But for each taxpayer the amount that he pays will not reduce the services available to him and his family or company. We are human, therefore, to try to escape taxes even if some nontax disadvantages result.

People do modify their actions because of a (high) tax. One consequence of this predictable aspect of behavior is that taxes can be deliberately designed to produce some desired nonrevenue effects, such as land uses which would not otherwise result. Sometimes the goals other than revenue may seem more important, at least to some people, than revenue. Actual conflict of interest in governmental policies must be faced as fully as facts will permit. Tax policies should harmonize with other. Proper balance must be sought.

If land-use and urban and suburban development plans are not complete and definite, then land values will be subject to an element of uncertainty. The effects of taxes beyond meeting revenue needs cannot be adapted as well as would be meet other needs. The role of city (and suburban) planning, of zoning and other directions for land use, must be paramount in achieving these vital objectives. Tax policy cannot possibly do this job, and to rely on differences in taxation to substitute for land planning is to assure much disappointment. Taxation can capture for the public treasury much of the value created by public actions affecting the permitted (and forbidden) uses of land and in building streets, parks, and other facilities. But a tax system cannot bring to successful completion the paramount purposes of good land-use planning.

Since the details of the tax laws are within the power of government, it should, other things being the same, try to select those which actually advance the other objectives, or hamper them the least. The tax laws for revenue ought to conform with--be consistent with--the policies for urban land use. Generally, however, as I have studied taxation I have become more aware of the disadvantages of using differences in features of the revenue system to

achieve other goals.

(III) Comparison with other Countries

International comparisons of taxes, must be used with caution. So many conditions differ from one country to another that comparing the role the any two or three elements of the economies can mislead; the failure to consider other features adequately may involve overlooking factors of significance. And even the best tax practice in actual use may not be the best that could be obtained. You want to achieve the very best possible. As regards land value taxation, your objective--one which you can attain--can be the best in the world (as far as I can judge from extensive travels and reading).

No country now gets as much revenue from land taxation as seems to me desirable in view (1) of the needs for (local) government services and (2) of the prices which must be paid for the use of land.

The use in Taiwan of all taxes related to property exceeds that of most countries. (For comparative purposes it seems better to include than to exclude house and deeds, taxes, but both alternatives have disadvantages). Relative to income, however, the use here is less than in the U.S.. Land value (including rural) and land increment taxes will equal about 1.8%

of National Income and 1.3% of Gross National Product. (I estimate. Figures are approximate at best. For 1971). These taxes plus the house and deeds taxes will be about 2.8% of National Income and 2.1% of G N P (in Taiwan). In the U.S. the corresponding figures for property taxes are around 4.4% and 3.6%. But in addition the U.S. tax on capital gains (not included in these figures) applies to gains on land somewhat like the LVIT whose revenues are included in the Taiwan figures.

Data for other countries as published in the Statistical Yearbook of the United Nations do not permit the kind of comparison which would be helpful here. A sampling of the tables in the section on "Public Finance" does not reveal enough cases of clearly identified "land" or "real estate" or "property" taxes to justify a complete study. My own knowledge would suggest that countries of the British Commonwealth may in some cases tax property about as heavily as is the case here (relative to national income and product). Canada is perhaps higher. No country to my knowledge approaches the United States, especially in some sections. (A special tabulation received on 26 August prepared at the International Monetary Fund, copy attached, shows "property taxes" in relation to G N P in many

developing countries).

Governments do not utilize even approximately to the optimum what I am sure is a very good revenue source. (1) One reason is lack of understanding. The basic principles have not been clarified and explained and taught. (2) Another reason is the difficulty of valuation. The administrative problems, however, are not too difficult for reasonably good solution even where staffs are quite limited in number and training if, and this "if" is very important, there is a real desire to make the tax work. (3) The lack of such desire plays a big part in actual results because of a third reason for the failure to make reasonably adequate use of land taxation. Owners of land exert influence on governmental policies. Such pressure is only natural. But the general public interest does not in this respect necessarily conform to the private interests of landowners. An owner of considerable urban land will have good reason to concentrate on keeping taxes from rising; the far more numerous members of the general public will have, on the average, too, small a concern in the other direction to apply equal effort. In more than one place there is enough influence from landowners to prevent land taxes from channeling to public treasuries more of the financial bene-

fits of social development. Yet social progress does much to create urban land values. (Sometimes, of course, profit-seeking private ownership does contribute to actual usefulness of urban land).

Present Weight of Land Taxes in Taiwan

Land value tax in both Taiwan Province and Taipei in 1969 and 1970 will average about 1.9% of the declared value. In % of cases declared value is 80% of the value estimated by the government. And those are below the actual market prices as indicated by announced current values; if the level of government estimates (1968) is now 90% of the market, then the tax applies generally to 80% of 90%, that is, 72% of market value. If the original values were more nearly 80% of the present market prices, then tax is paid on around 64% of the present value. A tax of 1.9% would in the first case be around 1.37% of the current market. In the second case it would be 1.22%. (In the United States, where in my view land taxes are lower than is desirable, the general average rate would be nearly twice as high as in Taiwan.) In some areas it would be much more. The U.S. does not have a LVIT, but the income tax on capital gains reaches increments of land value and over time will tax a considerable portion--but by no means all--of increases in land prices at rates as high as 25%, or (more in some cases).

The rates here, of course, cover a wide range--from 0.7% to 7%. On taxable value the average actual rate went from 0.7% to 5.6% (*Taiwan Province*, second period, 1970; for Taipei the average for the seventh grade was 4.88%). The marginal rates, however, are higher than the average; and the marginal rates are the more significant for influencing the behavior of the rational landowner. On current value, the actual marginal tax rates probably went from around 0.4% to 4.5%. A range of rates from one to ten will in itself create problems for the economy, as discussed later.

In Taiwan Province, and also in Taipei, approximately one fifth of the landowners paid the lowest rate--0.7% on declared value. And around 70% paid the 1.5% rate, which in 1970 was probably not much, if anything, over 1% of current value. For the whole island 153 out of 606,000 paid some tax at the top 7% rate on declared value.

"Burden" of Land Tax Difficult to Determine:
Effect on Land Price

Is the general average of less than 1.4% on market value "low", "moderate", or "high" in ^rrelation to some meaningful standard? To answer such a question for a tax on income or on a product, we can make a judgment. The tax can be related to a

base, perhaps 10% of a salary or--12 cents (U.S.) per gallon of gasoline. The base, that is the price or the amount, is determined independently of the tax on it. For a land value tax, however, the problem is more complicated. From one year to the next, the tax will itself affect the price of land and thus the amount of value to be taxed. Other things remaining the same, the higher the tax--NT\$1,000 as against NT\$800--the lower will be the market price of land. When the tax rate is increased, the immediate burden will include any resulting drop in the land value. (Thereafter, the tax is not a real burden on the person who has paid a lower price which was a result of the higher tax on the land). A land tax at a "high" rate on current market price of all land may in fact impose no true burden on some owners and rather little on most others. But a high rate which applies to only a portion of the land in a city will burden the owner or user because the "extra" amount of tax will not be subject to capitalization on any general scale.

Raising the tax rate on gasoline will raise the price of gasoline. But raising the tax on land will lower the price. The quantity of land will not go down. This relationship differs fundamentally from that for products and services. The significance is

of the utmost importance for getting revenue to pay the costs of government.

This effect of tax on land value helps to explain why economic analysis (beyond the unearned increment aspect in its customary meaning) supports greater use of land taxation than might otherwise seem reasonable. The owner or user pays less to get the land when the tax is higher, therefore, he does not really carry a burden of tax even though he does pay funds to the government. (This point is discussed more fully in an appendix). (A second reason for relying more on land values than might seem normal is that the tax revenue raised from the land value tax may be used to pay for the services of government that benefit the community. These benefits can affect land prices positively.)

Land has value because it brings benefits. (In some cases, such as on Taiwan in recent years, these may to a significant extent include the possibility of a rise in price--"speculative value".) The flow of benefits has worth whose total will be valued in the market in relation to the income from other assets. The gross earnings as capitalized do not determine the land price because ownership may involve obligations--such as paying tax. (Develop this point).

(IV) Equalization of Urban Land Rights as a Guiding Principle

(This section includes some discussion of land value tax as such. Time has not permitted revision to sharpen the organization and to reduce duplication). As I began this duty and tried to understand the principles which Chinese tax policy seeks to follow, the concept of "equalization of urban land rights" obviously demanded attention. The progressive features of both LVT and LVIT seem to rest in part upon the concept, and so does the importance attached to taxing increments of land value. The meaning of the concept will probably influence decisions on some points and the usefulness of my suggestions. Translation may not succeed in conveying all the aspects intended. So I try to express what may be relevant interpretations.

Differences from Rural Land

For rural lands where the source of income is work on the land, the access to land has vital significance in a way that can be seen. The income for living will depend heavily upon the amount which must be paid for the use of land (to a landowner or to government in taxes). The home will be on, or close to, the land cultivated. Rural land reform, therefore, could be guided by a concept of "equali-

zation" which was probably clear.

In urban areas, however, the conditions differ significantly. "Equal" has less clear and useful meaning. Shops and stores need land, often but by no means always, about the same amount of area for each. Factory and office work must use land, but the amount of land per worker (in area) is usually small, not necessarily equal from one business to another, and having no necessary relation to the areas per worker for stores.

Obviously, too, the dollar values per unit of area can differ tremendously. Therefore, equality in area and equality in value mean very different things.

Urban areas consist of many units of land and many users. Any of several particular pieces of land will ordinarily serve about as well as other for any specific user. To the owner any one of many possible users will be equally satisfactory. Furthermore, the worker will not as a rule have any real need to own the fraction of the land area on which he works. The security and productivity of the job will not be associated with ownership of the land as in farming. Some of the success in agriculture depends upon maintenance and improvement of the land; they go better with ownership than with

tenant status. Urban jobs, however, are largely different in this respect. The majority of workers, I assume, are very much better off if someone else owns the land of the job--a point which is obvious when made. In a sense a large holder of business land is doing the employee a favour.

Where living in the city is not on the same spot as the job, the choice will not be limited narrowly in the same sense as for farm population. Transportation makes a wide range of locations available near or farther from work. Shortage of land for housing may be serious but for reasons other than that any one family must have any one specific location. In cities, land for housing takes on a significance different from that of rural life.

For many city persons, as compared with rural, permanence on one specific location, one lot as against another, would seem to be less generally important, at times, however, business location (retailing and service establishments) will have value which is not fully transferable to another spot. In rural areas, as noted above, investment in the farm itself is a significant factor for longer-run improvement of productivity. For much of urban economic life, however, the capital investment which has a large role in making jobs more productive is not

much associated with any specific piece of land for a company. New and better machines can be used in any of many locations. In cities land is only one of the nonhuman instruments of production. With corporate ownership, the economic value of land can be converted into shares of stock.

Is Monopoly of Urban Land a Realistic Danger?

Discouraging land monopoly is one of the reasons I have heard cited for the progressive rates of LVT. But in urban areas what is the reality of "monopoly" as the term is applied to land? The number of separated parcels of land is ordinarily so great that only a few are "large" in the sense of comparing more than a truly tiny percentage of the whole. There are 108,000 landowners in Taipei 14,000 in Keelung, and so on. As regards an urban location, the owner's power is both strong and weak.

A single owner can keep others from using his particular land, trying to get a high price. Other land nearby will usually be of almost equal usefulness and thus offer very close competition. Many other plots can serve about equally well. Therefore, exclusion from one does not mean the kind of exclusion from alternatives which is ordinarily a condition of monopoly. In most cases, the area within cities is so divided into numerous plots or parcels that no

one owner controls a big fraction of the total. (In Taipei municipality all of the 44 largest holders (in value) combined own 6% of area and about 9% of value. In Taiwan Province the 109 landowners paying LVT at the top rate owned about $3\frac{1}{2}\%$ of the taxable area and 4% of taxable value in 1970). Even if one makes very generous allowance for possibility of that concentration now would be higher if LVT had not been in existence, the general fact seems clear. "Monopoly" is not a truly descriptive term if it means, the control of much over half of the supply of something. The land unit over which one owner does have great power is not a big fraction of the total land which can serve the many purposes of the potential users in the area.

Yet in another sense the concept of "monopoly" in urban land does involve issues of importance. The ownership of a piece of urban land can give power which greatly exceeds the power that results from the worth or productivity of the parcel itself. (A producer of shoes has economic power because of the worth of the shoes). The owner of one plot can sometimes influence what others nearby will do with their land. Thus he has power which relates to the total of land whose use he can influence without owning it. From the other side of the coin, the use

which one owner of city land can make of his plot will depend upon what is happening in the neighborhood. To significant extent he is at the mercy of other land-owners. Good city planning, zoning, and guidance of land usage can make a difference in the power of individual users and lead to better total results.

The present progressive rates apply if an owner's holding in a city are in one plot or a dozen or more.

Advantage of "large" Units of Land: Consolidation

Some modern urban development to be most fruitful, most productive, and most attractive must be on a "large" scale. Because some land is scarce (high in price because of good location) it must be used intensively. Both building height and the land area of the development must be bigger than in the past. The two--height and ground space--are related. To be economical, a tall building must serve many users because the cost of the electrical, elevator, heating and air-conditioning, plumbing, and such facilities must be spread rather widely; and to accommodate this number, the ground area cannot be "small". Water and gas and electric and sewer facilities can be less expensive per user in a larger-scale project. Aesthetics may also call for planning on a considerable scale. The ground space needed can be greater than that of several plots of land of typical size.

The small units which have been economical in the past, as for small shops or factors, cannot meet some modern needs of great importance. Two, three, five, twenty, or more times the space is required. And many users benefit.

Fragmentation of Land Hampers Best Use in Some Cases

A tax policy which under the designation of "equalizing urban land rights" discourages such projects will in this respect obstruct a desirable type of urban development. Tax rates of 7% as against 1.5% of value will add to the owner's costs (but not because the owner is using correspondingly more of productive capacity or getting relatively more government services). I have not seen figures of how costs per unit of floor space might differ and feel sure that in some cases of high rise buildings the effects would be unimportant. But at many margins the tax-cost disadvantage of large-scale projects would be of concern. If there is "equalization" in such cases from keeping parcels of land smaller than market forces would call for, the public suffers a disadvantage but one which few people will ever recognize. (A form of "excess burden" results).

In another sense the aspect of "monopoly" noted above has additional meaning. It will be encouraged

by tax policies which favor small holdings. Assembly of separate parcels into a unit which is large enough to be usable can be held up by one or two owners. A person with land in a strategic location relative to other plots being consolidated has great power. In this respect the term "monopoly" may be somewhat correct. The meaning differs from that of a manufacturing or other company which is a "single supplier" of a product. The monopoly producer may charge consumer more than is necessary to get the product to market. The owner of a piece of land can sometimes hope to get more than it is "really" worth, its location relative to other pieces enables it in an economic sense to exert a form of exploitative monopoly power.

Fragmentation of holdings will enlarge the number of landowners who can get some potential power over "neighbors"--and enlarges also the number of owners who can suffer if they wish to assemble land into a consolidated plot. The development of an urban area can be obstructed and hampered by difficulties of land consolidation. The community as a whole will suffer. This result is hardly the beneficial type sought through "equalization of urban land rights". The progressive rates of LVT work in this direction.

Yet by how much? The scale of tax graduation operates differently from one place to another. If fragmentation is desirable, and if the tax instrument is to be the one used to bring it about, rather than land-use controls, should there not be more analysis to clarify the reasons for wanting more dispersion of ownership?

I have not been able to study the practical possibilities here of using corporations and other devices to escape tax progression. Apparently, some such methods are used. What are the results? One must be an unfortunate inequality in the actual application of the law. As a general principle, I believe that a society should not try to continue tax policies which cannot, or will not, be enforced to assure broad application in actual practice. It is not desirable to tax "honesty" or unwillingness or inability to utilize legal and illegal methods of escaping tax.

Taking Benefits for Public Use

If "equalization of urban land rights" is interpreted to focus on benefits from the land--rather than on the dispersion of ownership (the anti-monopoly aspect)--the possibilities of achieving the objectives change. One practical way to give the general public the benefits from urban land, as recognized especially in LVT, is to take a part of

them in taxes. The money can then be used to pay for government services. In this way, ownership and some of the benefit can be left with private individuals or companies. But a part of the truly significant benefits, the income, will go to the public as a whole.

Things, including land, have value because of the services they produce. The benefits which land yields may be a farm product. For our purposes, however, we are concerned with the use of space and location in a city for housing or business. Such results may be in a combination of forms which are not always easily valued and separated, especially when the owner occupies the property, as for a business. The advantages of a sense of personal security from owning land are also difficult to measure. But in any case, however, whoever may be the legal owner of a piece of land, what counts most is who gets the benefits.

Land (or other property) produces a flow of benefits. They come into existence from one period of time to another. They may be more or less regular; they may be uneven seasonally or from year to year. One reason for holding land, as you need not be told, is that it may be a source of added wealth due to general growth of the society rather

than to effort and owner's investment to make them better. The fact that some owners have gotten handsome gains without much effort builds in others a hope for speculative gains. People will pay for the right to get future increments; but estimate of the amount and timing of future land prices will differ, and the worth this year (1971) of uncertain amounts (2x or 10x) at uncertain times (1973 or 1978) will be subject to very different appraisals.

In Taiwan today through the LVT, and in some other countries, government by taxation takes a portion of each year's flow of benefits from land. The size of the tax determines the portion of the real product which goes to the general public. The average rate here in Taiwan of less than 2% of market value may compare with gross yields of, well, how much in Taiwan? Excluding the expectation of price rise (which for present purposes is not really a correct procedure), if the gross yield in a freely competitive market would be around 12% the average LVT takes about one sixth. If gross yields are around 15%, the tax is less than one seventh. (The tax, as we have shown, will affect the price of land). A higher tax rate could take more, but even the very highest rate which is likely to be considered seriously for taxation in Taiwan would not absorb a

really "large" portion of the whole. But the speculative element in land prices has pushed some prices so high that current gross income will fall much short of 12% (?) of the market price, 6% perhaps. In such cases the tax will seem high as a percentage of the current yield (expressed in relation to capital value and not including the hoped-for element of rise price) because the price has a large artificial (speculative) element.

Whatever one may think of the desirability of complete public ownership of land as a way to capture unearned increments, no prospect of extensive government ownership seems at all realistic. In fact, the lack of funds retards the purchasing of plots which are needed for immediate public purposes. But there is another way--the LVT--to get each year some of the element of unearned increment but not limited to it. The higher tax to be paid in cash would add to the owner's pressure to put land to uses bringing more current yield; the higher tax would reduce the withholding of land for speculative purposes and thus make for lower land prices (in addition to the capitalization effect).

An increase in the land value tax (with the funds earmarked for local government purposes) would channel more of the benefits to the general public. If

the money is spent reasonably well, the locality will be a better place for everyone. The good effects will be felt on land prices and in this way offset some of the initial effects of a higher tax in depressing land prices. When land prices go up because the city is a better place to work and live, the results are significantly different, and better, than when land prices rise because of speculation.

The LVT would reach all land, not merely the plots which are sold and subject to LVIT. A better market in land would result because owners would have more inducement to get money income at once rather than to hold out for a speculative gain. For this and other reasons, I should think that the Republic of China would do well to rely more heavily on LVT. (See later)

(V) Land Value Tax

Of the land taxes, the land value tax is the largest for revenue over the whole island. (The rural land tax, however, brings more outside of Taipei). The LVT yields half as much as the personal income tax. Most U.S. economists would consider the income tax much preferable as a revenue source, but I would insist that by reasonable standards a tax on land values ranks about as high

as, or higher than, an income tax. The LVT will presumably continue to be a main revenue source and could become of greater importance. It deserves attention, not only for its revenue effects but also for its influences on land use. If more revenues are sought from this source, then the various economic effects will be of greater concern. Comments on certain points will be made briefly.

Rates Fixed Nationally

Rates are set by national law, not by the units of government which utilize the revenue source. Some scope for rate adjustment by the authorities spending the funds deserves consideration. In the U.S. (and I do not cite our practices as necessarily best for Taiwan) local governments using the property tax ordinarily have authority to determine the tax rate, often subject to ceilings (set by state law). In the U.S. there is a view held widely (but not uniformly) that communities ought to have some freedom to express preferences and set priorities in local government spending--both the general level and the balance among functions--but with responsibility for producing the necessary revenue if total spending goes above some level.

(a) On Taiwan some differences among areas may call for differences in spending which could

appropriately be paid for by LVT.

(b) Or land values may changes in rather different relative amounts so that governments will need different rates of tax to pay for the same level of government services and facilities.

Some flexibility in the LVT rate would give more opportunity and for local decisions; it would also relate the responsibility for spending somewhat more with the responsibility for deciding on the taxes.

Progression of Tax Rates

The graduated rates are unusual. (I can think of no other governments with such a range of rates for property taxes. And I note in Dr. Sun Yat-Sen's lectures that he uses a single rate to illustrate his points). The principles or logic which are generally accepted as reasons to support rate graduation do not apply in this case with one possible exception.

(a) Special Low Rate on 3 acres for Owner-Occupied Dwelling. Supporters of the 0.7% rate (slightly less than half of the starting rate of 1.5%) probably cite it as an aid to persons with low "ability to pay" taxes. If so, it is in line with one reason for tax progression. (In parts of the U.S. special provisions are made to reduce the property tax for somewhat the same purposes). As an aid to those who

are least able to support government, this feature accomplishes almost nothing because the lowest income families do not own land. Those who do benefit will be above the level of poorest income. Families in the highest income groups also qualify for benefits. (In Taipei the land in this class averages about NT\$4,300 per ping. (check) This amount is almost twice that of the value of the average of land subject to the tax at the first grade rate of 1.5%, but the NT\$4,300 it is the same as that of the top grade). In an imperfect world we cannot expect that all features of tax policy will measure up ideally. This one does not rate well as an aid to those with least ability to pay tax.

Another argument in favor of the low rate may carry more weight. It would emphasize a desire to encourage home ownership. This reason would certainly have much appeal in the U.S. The effectiveness is difficult to judge. Does a higher price of land offset some of the benefit? Is the tax reduction large enough to exert much influence? The revenue loss is not "large". Applying the starting rate of 1.5% to this property would increase the total LVT yield by slightly over 3% in both Taipei and Taiwan Province. Since a preferential rate for homeowners now exists, retaining something

of the sort may seem better than attempting what in the U.S. would be very most difficult politically. The present rate might be raised, however, if other rates are increased for revenue reasons.

(b) Otherwise, the customary justifications for tax progression appear to be more in conflict than in support of the present LVT rate structure. Holdings of land (in one areas) do not represent ability-to-pay taxes in the sense familiar to me. (i) For one thing, net value of holdings is not the basis of the tax because no adjustment is made for debts; gross amounts of ownership do not constitute the normal meaning of ability-to-pay, whether wealth, income, or consumption is the basis for progression. Offsetting debts must be taken into account. (ii) Moreover, the LVT does not consider other property in computing the tax base; two people of very widely differing net wealth might have equal totals of land. (iii) Perhaps owners of more land get more services. True, but looking to services received by an owner or user of lands as a basis for sharing the costs of government according to benefit justifies proportional, not progressive, rates.

(VI) Income is Subject to the Progressive Personal Income Tax

An even clearer departure from the basic logic of tax progression results because the land value progressive rates apply to the holdings of corporations. (Whereas the basic tax at the initial rates will generally be capitalized so that present owners are not burdened, as discussed elsewhere, the higher rates--4% to 7%--will not be so generally capitalized by market forces. The number of buyers and sellers subject to the top rates is too small. So owners, in this case the people who own the corporation do bear some of the tax). The shareholders will have wealth and income (and ability-to-pay tax) of large and medium and in some cases only small amounts, quite without regard to the corporation's ownership of land. Relating the LVT to the probable income from land, we find results which are more realistic. If land produces an income, of 14% of capital value, a 7% tax on the value is 50% of the income. Anything of this magnitude will certainly exert influence to escape the tax.

In Taipei out of 80 owners subject to rates of 5% and higher (1969), 9 were individuals. Three times as many, 28, were private enterprises. Over half of the total, 43, were "government enterprises, nationalist party, and ancestral worship foundation". For the groups subject to the 3% and 4% rates,

individuals were relatively much more important-- 119 out of 197, with private enterprises accounting for 51. No rational relation of tax to ability-to-pay seems to me possible in such cases. In discussions of the progressive rates I have found that people think in terms of large holdings by (rich) individuals. Yet in fact most ownership subject to the higher rates is by institutions representing in one way or another many individuals.

The rate graduation does bring more revenue than the initial rate (1.5%) alone. In Taipei the 7% rate does bring appreciable yield. But for all of Taiwan the yield from rates above 4% is scarcely more than slight. As is usually the case when rates range rather widely--in a range of one to 10 as in this case--the top rate adds less to yield than is probably assumed. The revenue attributable to rates over 3% can scarcely be termed "large". An average of 2%, while retaining the 0.7% rate for small residences, would bring as much as the present scale. Revenue results, therefore, cannot be said to make the progression of rates necessary.

To repeat, this tax does not seem to me one which should be progressive. My conclusion is reinforced by the defects, in my view, of the system of determining the actual brackets for progression.

Starting Value for Progressive Rates of LVT

The progressive starting value system as a basis for land value tax rate progression causes the tax to vary from one city or hsien to another for persons owning the same dollar amount of land. Per dollar of land owned, individuals and businesses where land is of higher average value will be subject to less of the progressive rate than owners where the value less. What causes the tax difference is not the gross or net wealth of the landowner; it is not the gross or net value of land, or the spending of local government funds. The differences in LVT per dollars of value owned depend upon a combination of factors which do not conform to what I would consider rational criteria for sharing the expenses of public services.

In the first half of 1970 the starting values ranged from NT\$86,600 to NT\$825,000--a ratio of one to 9.5. In 6 cases the figure was over NT\$ 300,000; in 9 it was less than half as much, under NT\$150,000. The dispersion is very great. And it does not, I believe, reflect a rational basis for differentiating payment for the costs of government.

If there is desire to have the tax vary (per dollar of land value) from one locality to another, probably the most logical basis would be variations

in local government spending (of those types which bear more or less directly on the use of land). Where spending on local infrastructure is higher than average, it seems reasonable that the taxes for local purposes would also be higher per dollar of land value. (Most LVT revenue goes to local government). The effects of differences in the various levels of local government spending would gradually be reflected in property values. The amount of land value tax paid would then be higher as land valuation took account of the positive effects of large spending. But if the present system of setting the starting rate were continued, the progressive rates would be imposed at higher money value than before. For example, if the progressive starting point were NT\$150,000 and then went up to NT\$170,000 because of productive use of taxes in local spending, the 2% rate would become effective at NT\$170,000 and the third rate at a figure NT\$120,000 higher than before. In other words, the lower rates would apply to more property value. The brackets or stages would be wider. This result seems to me illogical.

Purely speculative increases in land prices also have an effect which is probably not desired. They raise the average values for the community. Then the progression which rests on multiples of the

average takes effect at successively higher rates. The third rate, for example, becomes effective at just over 6 times the starting value. The total tax due will rise by less than if the progressive rates took effect at the same money values as before.

When an area's boundaries change, the average of land value will also change and thereby change and so will the progression. This result also seems to bring inequitable results.

Division of land is encouraged by the existence of differences in the tax rates, how much? Owners are put to some disadvantage to get around the provisions. (Excess burden results).

Absentee Ownership

Putting heavier land tax on absentee owners discourages the import of capital those from another area for the purchase of land. The amount of tax collected--about NT\$ --indicates that some people do pay. The effectiveness of methods of escaping tax is not clear to me.

In general, a developing economy needs capital, and getting the savings of others has merit if the terms and conditions are satisfactory. (The term may not be attractive and yet be the best available and better than nothing). The exception to these broad conclusions may be land.

New capital coming into an area does not increase the amount of land (as space). The size of a city in the sense of area does not grow when more funds are spend on the land. However, if capital comes in from outside and pays for land, the seller has the money. He may then use it for buildings or other improvements. In this way, the capital from outside which paid for land does, in effect, finance additions to real wealth even though the amount of land area does not increase. Later, the payments of rentals to the absentee owner take income out of the area. Hopefully, the capital will produce more net income than is needed to pay rentals. To some extent the considerations are like those of international economics.

National law prevails. Local governments have no choice. Even if a locality wished to avoid discouraging capital from outside for land purchase it cannot apparently eliminate the tax. (But in actual practice most business companies of the type which would be desirable would not be subject to tax because actively engaged in operations).

Land value tax discriminates against absentee owners of land. Why discourage capital import? Perhaps to keep land prices lower than otherwise. (Since this is a national tax, there is no effect of

deliberately depriving local owners of land in a few areas of an opportunity to sell for higher prices). Is there some belief that outside owners are more often "speculators" who will keep the land from best use, largely idle? Is the special tax provision based on a feeling that outsiders will not make such good use of land as people locally? Was there special evidence or some special reason (perhaps "horrible cases") leading to this provision? Some historical review of the origins might be helpful.

In general, the effects of such a tax on the efficiency of the market process in land would not be helpful or constructive as improving the allocation of capital and land, better guidance, choice. Some "excess burden" results because owners must follow practice which are less than the best for them (in the absence of need to escape the tax).

Is not avoidance possible though dummy owners, relatives, or others? If so, why continue to have a law which will be only partially effective?

The proposed exemption for Overseas Chinese would be limited to one house only.

Because of Taiwan's need for capital, any discouraging of imports of capital, even for the purchase of land, seems to me undesirable. Certainly for the longer run, the policy ought to be reconsidered. The

1968 experience must have had been a unique combination. In the future, it seems to me, any sudden surge of land purchase with funds from outside Taiwan would hardly be large enough to raise the now high level of land prices here by very much in percentage terms (except for very special cases). One of my personal "principles of taxation" applies broadly: Good tax policy for a country as a whole--especially for the long-run--cannot be determined by special cases. Particular experiences, such as the 1968 demand for land by Overseas Chinese, are poor bases for general, long-run tax policy. Any future combination of special circumstances would not be the same. And the more normal conditions are different.

The economic effects of the provision on an area will probably depend in part upon the actual applications as to business companies. Perhaps they will be able to conduct enough activity to retain status as "non-absentee".

Vacant Land "Surtax"

The higher tax rates on vacant land will put more pressure on owners to sell or to invest more in improvements. Some owners, I assume, are already taking the action necessary because not much of the time of the period of exemption remains. If owners

are not now using land to best advantage, there is some reason.

The tax can be large, presumably, in relation to after-tax income. The necessity of making larger payment in cash will be a pressure whose force may exceed what might be expected from the dollar amount itself. The extra tax, however, will probably be small compared with any LVIT, and it discourages sales. The net force of the added tax liability is difficult to estimate.

As a policy this is intended to offset what are apparently considerable amounts of underutilization of land. This a "control" tax feature rather than one for revenue. The additional tax revenue, which I assume is not the chief purpose, may be justified as compensating the community somewhat for loss of economic activity (and tax revenue) due to underutilization. One result will be some decline in land prices as owners try to sell. Another result will be added demand for materials and the construction labor needed for making the new investment on the land. Several questions arise.

Will the economy be able to supply such productive resources? Is there now enough underutilization of the types of productive capacity that will be needed so that significant price increase will not

result? Will construction be shifted from uses on the "extensive margin" of cities to greater concentration in areas closer in the community?

Are land-use plans prepared for a new set of pressures for construction? Is there any reason to expect that the priorities of any new building will conform with those best suited to urban plans? Some land-owners will not have the capital or will not wish to use it for such purposes. Will credit facilities be available? Are those who can finance likely to be the ones whose decisions about what to build would be best?

On these and other points conditions will differ from one place to another.

If the tax is retained, the definition of "vacant" may need modification as experience is gained. Administrative problems will certainly arise. What methods of legal and illegal escape of the tax are likely to add to difficulties of enforcement?

Possibly, some disruption of the land market, and other unfavorable conditions, will appear. That is, some results of the added pressure will be "abnormal". \

In short, on the basis of what I now know, I strongly doubt the wisdom of this extra tax. The final answer would probably depend upon the effec-

tiveness with which it seems likely to advanced land-use goals. As a revenue measure, it will not, I believe, have enough merit to justify retention. If continued, the long-run need for such a differential rate ought to be reexamined in the light of experience, land-use policies, other tax provisions, and all relevant matters. The LVIT, for example, must tend to discourage some sales when owners for one reason or another do not wish to develop the land. The LVT may not be high enough on most properties to exert great pressure. So in some case a new tax impulse could be helpful. The proposal for higher LVT over the years will add to the force of taxation.

The expectations about further land price increase will make a great difference in the desire to hold land vacant. If there is a drop in the expectations of land price increases are to for an area or type of property, less "withholding" of land in underutilization can be expected.

If land prices are reduced somewhat on some areas, the LVT and LVIT revenue will perhaps decline or fail to rise.

Payment of LVT might be more convenient on a quarterly basis.

Indirect Easing of Financing: Better Market in Land

A tax increase on land will tend to reduce the land price. But the change will not reduce the total costs of ownership for someone buying at the lower price.

One result of these conditions is receiving more attention by economists in the U.S. Let us illustrate by assuming that the purchase price is met by borrowed funds plus the purchaser's own funds on which he could get interest. Other things the same, a purchaser will pay less in price after the land value tax has been raised. His annual interest cost will then be less. But he will pay more each year as tax. We can correctly assume that the two amounts are (virtually) the same.

It might seem that the position of the new buyer will not really be any different--less in interest each year but more in tax. In another respect, however, the position of some (potential) buyers will be improved.

The change would favor the person with less capital. It would do so without making things harder for the person more amply supplied with funds. Because price is lower a buyer could acquire land with a smaller outlay; he would need less of his own resources and less borrowing. As a result of this change, more buyers, especially those with below-

average capital and access to borrowing, would have a chance to acquire land. The market in land would be better because it would reflect more judgments of persons in a position to bid for land.

Would results along this line in Taiwan be significant? I have no solid basis for an answer. But even in the U.S. capital markets are imperfect. For many persons and businesses the access to borrowing is limited by a variety of factors such as lack of established credit rating, shortage of ownership capital, and limits on funds available from local institutions.

(VII) Land Value Increment Tax

The land value increment tax, to the best of my knowledge, is unique in the world. Other countries, including the U.S., would be better off if they took for the general public more of the increases in land values which are due to the general development of the economy. Capital gains taxes in the U.S. and some other lands do have some of the effects, but with the difference that most of the revenues are for the national government whereas local government may have a larger role in providing services which affect land values.

Role of the Tax - Prospects and Restrictions

Apparently it is the LVIT which most directly seeks to achieve the goals of the equalization of urban land rights as expressed by Dr. Sun Yat-Sen. The underlying reasons need not be summarized here, except to emphasize on intangible feature. Public attitudes and morals suffer from a feeling that some people get rich easily, from land speculation. Does not the cohesion of society suffer? A conviction that taxes will catch much of such gains can perhaps serve a constructive purpose in the society.

Three more points, are worth making. (1)The amount of unearned increment will probably be less, year in and year out, than may be expected here in Taiwan. Of course, I have no method, really, of measuring attitudes on this score. But they may have been influenced unduly by the rapid increases in land prices in the last 15 years or so. The surge of 1968 was probably the result of a combination of conditions which will not be repeated. The potential tax may develop less dramatically than recent experience leads some people to expect. But the amounts will be large enough to justify determined effort for capturing some of them through taxation.

The area covered ought to be expanded to cover the whole island as soon as feasible.

(2) Government ownership of land would assure that government received all the increment. But the government does not now own the land. It cannot expect through taxation the full results it could get from complete ownership. The resistance to very high exactions through taxation--rates of 80% or higher--will be strong, so powerful that much of the tax hoped for simply will not be paid. It is, I am sure, an illusion to believe that the results hoped for by Dr. Sun Yat-Sen from one set of circumstances can be obtained under very different conditions.

(3) Not all increases in land prices are due to general community growth plus such direct expenditures by the owner as referred to by Dr. Sun Yat-Sen ("trees, embankments, drains, and such," P. 180). At least in the U.S., some of the incentive for developers of housing, shopping, office, and recreational projects has been a rise in the price of the land. They hope to make a good profit for imagination, management, and risk because the land price will rise by more than the investment of capital. Here is an incentive which can operate constructively for all concerned. Though sometimes called "speculative" in the U.S., it is diametrically opposite of the result of merely holding land unused and waiting for the community to grow. Good develop-

ment of urban land can mean much to society.

Government has a big responsibility in city planning, zoning, and so on. The part remaining for private developers will probably be substantial. Hopefully, a land increment tax will not hamper greatly such effort. The income tax more properly applies. Somehow, a blending of the applications of income taxation and LVIT seems desirable in a tax system for the longer run. (This point will be developed further if time permits.)

(4) The use of a price index to adjust the amount to be taxed is desirable.

Basis of Progression

The progressive rates of 20% to 80% rates apply to the percentage of the value of the increment. Neither the total amount of the landowner's gain nor the total of his gains on all types of property will determine the rate of tax he will pay. This type of progression differs from the forms' generally used. The logic supporting this type of progression does have some appeal. The logic relates to the fact that the gain which is being taxed at the different rates from general economic progress rather than from the landowner's own efforts and investment. While different from any other justification for progression which I can think of, this may have more plau-

sability than one would initially expect. Perhaps one can support this focus on the percentage of the gain as against the income, wealth, or other characteristic of the landowner.

Yet percentages are "tricky". A rise from 1 to 2 is as great in percentage terms as one from 100,000 to 200,000. Are not the differences in absolute amounts, however, really more significant? As regards sharing the costs of government, the percentage of the increase in value is not obviously the most logical basis for determining how much more tax some people will pay than others.

Another result is that the total tax can differ tremendously for the same dollars total of gain, depending upon the number of owners in sequence. "Stepping up the base" modifies greatly the operation of the progressive rates. A total change from 100 to 500 will bear more tax if the gain is realized in one sale than if it is realized in several successive transactions. However, payment in a series deprives the owner(s) of tax earlier and in segments so that the dollar amount for reinvestment after each stage will be less than at the beginning.

No adjustment is made for the length of time the land has been held.

Scale of Rates

Questions will also arise over the scale of progression. Most of the reasons which are usually cited for a rather moderate starting rate for progression do not seem persuasive in this case, taking all other conditions into account. Certainly, since there is no relation to the amount of other income (or to some concept of ability-to-pay), the humane reasons for a low initial income tax rate do not appear base. Ease of administration is not a reason here. Revenue needs would support a higher rate.

A starting rate higher than the present 20%--at least 30%--would seem to be justified about as completely as the present rate. It would increase the yield. One advantage of raising this starting rate would be to permit a reduction of the top rates without revenue loss.

Very high rates of tax--certainly any over 50 percent--will substantially influence the way land-owners act. A tax rate of 60% or 80% is simply so great that it, not true economic soundness, will often determine decisions. Buying and selling will be discouraged. Tax that might be paid at a lower rate does not become due because owners do not engage in taxable transactions. Moreover, in a real sense the amount of land made available for best uses will be less than if tax did not reduce the marketability

of land.

The incentives to manipulate land transactions will be distorted. Artificial factors will overwhelm those of basic economic merit. The market in land will be made less effective. It will be less active, less competitive, less efficient in allocating that vitally important resource, urban land. "Excess burden" to the society results. And, as noted earlier, probably there is not revenue loss to the government as compared with the conditions of a lower rate.

My tentative first choice, if this form of tax is retained, would be a flat rate of about 40%. Next, and almost as desirable would be a two-step scale of 30% and 40% and 50%. (A difference of 10 percentage points is large enough to make a distinction but not so large as to open up inducements for manipulating affairs to anything like the present incentive). For the long-run, as noted earlier, integration with the capital gains portion of the personal income tax would be desirable.

Tax is paid according to announced current land value. If the actual price of sale is below this level, I understand, the seller must nevertheless pay LVIT according to the figure announced. Such a result can be unfair, especially when tax rates are as high

as for LVIT. Such a provision would seem to need reconsideration.

A government seeking a temporary boost in revenue could give rate reductions of increment tax for sales within a year or other limited time. A "bargain" tax can have a pronounced short-term result. Land prices would fall somewhat for the time being.

It is unwise as a matter of general tax policy to leave the determination of a large amount of tax to the taxpayer and to actions under his control. On some aspects no alternative may in fact exist. For example, "realization" for capital gains taxation depends almost everywhere upon the taxpayer's decision to act--his sale--or not to sell. For this reason, the necessity of leaving the amount of tax to an action under the control of the taxpayer is generally accepted. Yet in some respects inequity among taxpayers can be substantial. Under LVT all pay each year.. Under LVIT only those involved in sale must pay. A few landowners pay a very great deal while most pay no increment tax.

In fact the amount of increment taxed depends upon the announced current value and not the actual sale price. Perhaps, therefore, part of the tax might be put on an annual basis. Any property owner with an increment above some figure--perhaps over

100% of his base--would pay 2% a year. The total of payments, perhaps with interest, could be credited against the tax due at time of sale. Revenue would be more regular. The incentive to delay sale would be less. Owners would be treated more equally year by year.

A study of methods of legal avoidance and illegal evasion would provide more concrete indications of measures which might increase the effectiveness of the tax.

Greater opportunity might be offered for tax-free (or low-tax) exchange of one property for another. In discussions of capital gains taxation in the U.S., we speak of "tax-free roll-over" (not now generally permitted). A more active market in land would perhaps result.

The shifting and incidence of this tax would warrant analysis. Time limits have not permitted me to try to trace through the steps of the various subtleties of the shifting of this tax.

Land Prices Can Fall

The longer-run trend of land prices in general will presumably be upward. Everything in experience and logic seems to support the conclusion which is widely held (and support it even for periods when there is no rise in the general price level, no

price inflation). No one, however, owns "land" in general but rather specific plots of land. Taiwan includes many parcels of land of widely varying nature. Some may fall in price.

(1) If today a considerable speculative element remains in some land prices, this portion (or part of it) may be squeezed out by one or more force. (Although "speculation" is difficult to define, I refer to an element of price which cannot be supported by the income which would be paid for its use in a free market in the near future). Such results would be hailed as desirable by many Chinese. A psychological change may occur, affecting perhaps only some types of property such as old centers of cities. Inflationary expectations (about land prices) may drop. The effect on some land prices might be significant. The demand for the land could be reduced and the supply increased by a change in the psychology of land price expectations.

(2) Some land in the normal course of events will become less desirable as portions of older localities stagnate and as changes are made in streets and other features. Prices of such plots may then go down, perhaps for many years they will stay below an earlier level. Even though most land prices are rising as an element of normal economic

development, exceptions are to be expected as communities change their character.

A related point can be added. The "normal" rate of long-run rise of land prices in Taiwan will probably be less than may now be than wisely expected. Obviously, I have scarcely any qualifications for judging the expectations of landowners here. But the rapid increases of recent years may have encouraged beliefs that some such (rates of) increases can continue. For important parts of the urban land area, purchases in the past, may already have raised land prices so that they now in fact discount much of the real growth of the next few years. If so, the room for price increases of such land is limited even though the general economy does very well.

Two points follow from whatever validity there is in the conclusions above. (1) Budget plans should take care to be realistic in estimating LVIT revenues. (2) Additional importance attaches to keeping valuations up to date. Owners paying LVT should get the proper allowance for any land prices declines which occur. Elementary fairness calls for such actions.

Of course, present land price include large amounts of increment which have not yet been taxes. There is a tax base of such increments which are

yet to be taxed as the property is sold.

(VIII) Valuation of Land for Tax Purposee

Utmost importance attaches to the quality of the valuations for purposes of taxation. (1) The amount of revenue depends upon valuations. Since the tax rates are now set by law, the actual tax which the government will receive is determined by the valuation. (In the U.S. the governments using the property tax ordinarily have authority to adjust the rate of tax to meet a revenue goal after learning what the valuation total will be. That is, if the spending to be financed out of the tax is 2,000 and the total of valuations is 50,000, the tax rate is 4%. If the spending next year is to rise to 2,300 and the valuations go up to 55,000, the tax rate rises to 4.182%). Keeping values up-to-date deserves strong support. (2) The fairness of tax burdens as among taxpayers depends upon the accuracy of one valuations as compared with another. Since the LVIT rates get to very high levels, and the top progressive rates of LVT are also much higher than the starting rate, an error in valuation can be of considerable significance for both the government and the landowner.

The present land valuation system as I have come to understand it has great merit. A high degree of

confidence has been expressed to me in the general quality of the procedures and the results (especially as regards relative values). This view contracts with extensive criticisms found in many countries, including much of the United States, about tax valuations. Efforts to maintain the strengths of the system should be made, along with attempts to find and to utilize possibilities for improvement. One emphasis should be on ways to keep valuations up-to-date.

Intervals of 3 years or more for the general reassessment seem to me less frequent than may be desirable. Where land prices are as changing as in much of urban Taiwan. Pressures to keep in line with the market, up and down, ought to continue constantly.

The temptation to assess at values below market prices had in the U.S. produced much inequality, with some property underassessed much more than others; in our system the correction of inequality is made more difficult when properties are all valued at less than what the law actually calls for.

The separation of land and building valuations permits a kind of tax differentiation which seems to me wise. Fundamentally, the tax rate on land

can--and I believe should--be much higher than the rate on buildings. The quantity of land will not be reduced by a tax increase. But the amount of capital flowing into new construction will tend to fall if the tax rate on buildings goes up.

The annual reexamination of land values on a sample basis can keep figures more or less current (Except that averaging the last 2 years gives a downward bias during times when land prices are going up). Changes apply to classes of land in an area. The current land values have only limited use, chiefly for LVIT. They are not used for LVT. In an economy of change, such efforts--and even more complete ones--to keep the official figures from getting seriously obsolete deserve support. In most countries with which I am familiar; tax valuations are not so current. If the staffs for doing the work here need additional powers, sources of information, personnel, or other facilities, a strong presumption can be supported for incurring the expense or making other necessary changes.

Information is crucial. Facts about the market are the base of good valuations. A foreigner cannot know much about the factors, some of which may be quite subtle, affecting sources of data. Sometimes the efforts required are those of a persistent, im-

aginative detective. The workers responsible for getting data might be consulted as to conditions which might be changed to enable them to do a more thorough, complete, and up-to-date job. One suggestion made to me is to remove the penalty against buyer and seller for underdeclaration of current price and true terms of sale when land ownership is transferred. The penalty is not often effective, I was told, in forcing the supply of better data than would be provided otherwise. And it creates an obstacle to getting, on a more or less informal basis, information which can be of great help in judging actual market conditions.

In each county or city a committee meets each year to examine the evidence submitted by the staff before final figures are promulgated. This feature seems to me to be one of strength. An outsider cannot learn how such groups actually operate in practice. But the procedures may make some contribution to the incentive for maintaining standards and preventing "slippage" of valuations in wishes of taxpayers for some tax relief. Perhaps the committee members also bring more information to help in making decisions.

These committees do not apparently provide any significant element of indirect participation by the

landowner. His actions are limited to questioning the proposed value for his land. The two members from the local assembly can presumably reflect views of the community somewhat. But, If I understand the system, they are not be able to plead for the owners of particular parcels of land. Protection against undue influence and bribery for some individual owners seems to be built into the system.

Today's procedures must, of course, differ from those of a small and relatively stable community, or an agricultural area, where landowners themselves have good knowledge of values. In urban areas in Taiwan change is, or may be, large. Many owners of land will have little accurate knowledge of current values. Such owners cannot be expected to make good contributions to the setting of values for announcement currently.

The opportunity for the landowner to influence within some limits the valuation to be used for tax purposes does leave him some meaningful room for action. The choice of being taxed on the 80 percent basis is the option most widely used. This opportunity in fact means that the LVT will be at least one-fifth lower than what would be imposed if the general values of the market were used. There is a form of self-checking, however, because of the use

of the figure for LVIT and perhaps for government requisition of land.

As noted earlier, valuations as promulgated tend to lag behind a rising (or falling) market. If market prices are generally about stable, the use of figures gathered over a 2-year period will not lead to much divergence from current values. But if there is a trend upward (or downward), then the use in 1971 of tax values resting on 1969 and 1970 market prices will lead to increment taxes which are generally lower (higher) than if current market prices were used. If the annual updating for LVIT is in fact incomplete, some of any revenue loss may be offset at a later sale.

Land value tax revenue not collected in one year will not be made up later.

The possibility of government purchase at a price declared below 80% may not in fact be an important "threat". If it is not, would the right of private purchase at x% above the owner's declaration be a constructive alternative? Obviously, such a proposal would be a very substantial departure from established practices.

(IX) Deed Tax

The rates of this tax are high enough to affect transactions greatly. A sale or purchase of property has no rational basis as an occasion for a large tax. Government is put to no appreciable expense on behalf of the buyer or seller. Neither receives any special benefit from government. Rate reductions are strongly recommended with revenue made up, probably, by an increase in LVT.

(Time has not permitted any detailed discussion of this tax. The shifting and incidence would deserve examination).

Appendix A

Excess Burden

Increasingly, economists call attention to a result of taxes which is called "excess burden." The concept has taken on greater importance as tax rates have become much higher than in the past. It has somewhat varying meanings. (Note: One aspect supports a flat-rate tax per person--a "head" or "poll" tax (not now necessarily related to voting at the election polls)—as better than an equal yield income tax. The latter will have some effect on effort and on the relative merits of money income and leisure. A fixed per capita tax of \$x per month leaves no opportunity to alter behavior to reduce tax. For an income tax, however, the amount payable depends upon choices about how much to work, how to invest, and so on.)

For application of the concept to land taxation in Taiwan let us say that the taxpayer sometimes incurs "excess burden" in the form of disadvantages due to taxation which are not matched by benefits received by the government. Why? Because to reduce their tax obligation taxpayers take actions which involve

some disadvantage to them. Holding land underutilized rather than selling and paying an increment tax is an example. But let us illustrate the principle with an income tax example.

Government, let us say, gets 100 from taxpayer A; he, of course, pays over this amount. In the "normal" course of events if he were using his economic opportunities in the most productive way possible (perhaps with resources worth 1000), his tax would be greater--let us say 120. But he has adjusted his affairs in ways that are less than the best (except for taxes). Perhaps in the use of his 1,000 he has chosen "second best" actions, which actually involve a sacrifice of the equivalent of 10 in output. The society loses 10 which was not produced.

Suppose that he could use his resources to get a gross benefit of 300 in a period of which 120 would go for tax, leaving 180. But by some other line of action he can get a gross of 290 in a way involving only 100 of tax. He is left with 190 and is 10 better off than before. But the economy has lost 10. The government does not get this. Neither does the taxpayer. The economy suffers. Government loses 20 in tax but probably has absolutely no awareness that it might have gotten 20 more.

Higher tax rates, and especially large differences in tax rates, will inevitably give rise to some such situation. They are "distortions" of economic processes which lead to poorer real results than could be obtained--and would be obtained if taxes did not change the way people carry on their affairs. Man's practical problem is to try to keep these losses, these "excess burdens," low.

In any economy at any time, one general pattern of economic activity will be closer than another to the optimum which is possible. One allocation of resources is more productive and efficient than another by standards or criteria of what people desire (in the broad sense). Governments must have income. They can get some total amount by any of several combinations of taxes. Each of these sets of taxes will affect individuals and businesses (1) by taking from them money which government then has for spending and also (2) by changing the way they act. The second is the source of "excess burden."

Taxes "drive a wedge" between what would be the best in the light of the inherent economic realities and what becomes best in light of taxes.

To avoid a land value increment tax of 60% or 80% or an annual rate of 7% in value, a landowner can afford to sacrifice quite a bit of what would be possible.

The entire process of reaching decisions must be greatly affected by tax rates which do not need to be paid when certain things are done, or not done. The owner or potential buyer of a piece of land on which increment would be high must look to the best advantage in light of the tax. His decision can produce poorer results for the treasury and the economy than if the tax were much lower. Some land transactions are not made, and so no tax is collected. And the better use of the land is delayed so that the economy suffers. An owner may be "locked in" by a high tax. If he has land which he could sell for 100 but would then have to pay LVIT OF 40, he would be left with 60 to reinvest. Even though he may see better use per dollar value of assets he may not believe that 60 can bring him as much benefit as he now gets from the land.

Some tax features are deliberately designed to give taxpayers incentives to act in one way rather than another. Inducements may be positive (the tax is lower than "normal" if one type of action is followed, such as ownership of land with a small house) or negative (the tax is greater than "normal" if some conditions prevail, such as higher LVT rates on land holdings above some amount in the same locality).

But the actual results will not be entirely and

exclusively those desired. When tax rates are very high, the incentives to escape tax can lead to actions which in a basic sense are much below optimal. But they leave the taxpayer in a better net position than if he were to do what is inherently most productive and pay the tax which would then be due. The losses to the economy are largely hidden. Few people may ever think about them.

Appendix B

Tax Bases: Three General Types

All taxes are paid by people. This fact may be obscured by the hidden and indirect nature of many taxes, including well over half of the total imposed in Taiwan (customs, commodity, and business taxes). Collecting government revenue through roundabout and concealed methods obscures the fact that "people pay" whatever taxes are paid. This appendix may help to understand, among other things, some aspects of the principles of tax progression. I oversimplify somewhat and ignore various minor points to focus on the basic principles.

People share the costs of government through more than one aspect of life: Three different capacities or sets of economic relations can serve as the base for taxation--income, consumption (spending), and capital (wealth). These three bases of taxpaying capacity cover the main possibilities. They can, of course, be used in widely different proportions. Each in itself consists of more than one element; consumption, for example, includes many, many different things.

Each of the three types can be used for a rational basis of imposing progressive tax burdens if all of the type is the basis. But if, for example, only 2 types of income or wealth are the basis of a progressive tax, the tax totals which result may have no sensible relation at all to the total of a family's income or wealth. If A has wealth of 100 and B has wealth of 150, it is these totals which are logically a basis for a meaningful progressive tax. But assume that A has 80 of land and 20 of other wealth and B has 30 of land and 120 of other wealth. Is it reasonable to tax A more heavily than B? I think not. But a progressive tax on land only will impose burdens which have no rational relation to total wealth.

General Coverage of the Three Bases

1. Income as payment for the services rendered in production represents the worth that the economy puts upon the contribution a person and his property make to society, their production. The worth of what someone produces--the value of his efforts and those of his property, what he puts into the economy--provides the basis of his income. Income is a flow through time, so much per year or other period. Income as customarily understood constitutes a family's chief means of getting goods and services.

The dollars which are used to pay any tax will usually come from the payments which one receives for his services.

In practice, the definition of "income" for purposes of taxation presents problems of great complexity. But they are not directly at issue in this report. Here we emphasize that income represents what the economy believe is the worth of the goods and services that labor and other productive capacity turn out in a period. The amounts received can serve as an acceptable basis for progression.

Such separate ("artificial") entities as corporations (which are distinguishable from their owners, customers, employees, and others who in fact bear the burden) have income. This fact can and does confuse matters of taxation. It is tempting to tax them, and perhaps at rates which are progressive. But the persons actually bearing the tax on corporation may have incomes of vastly different amounts.

2. Expenditure (sales, purchases), roughly conceived as a close measure of consumption, represents what a person or family gets from the flow of production.^{1/} What someone takes out of the total produced by the economy is what he can consume. No one else can have it. General sales taxes and specific excise taxes apply to this base. To apply progression in

such taxes is impossible except for moderate elements. A spendings tax which applied to all spending could be made progressive if computed on an annual basis somewhat as the income tax. India and Ceylon, I believe, have tried to impose such taxes. The U.S. Treasury proposed one during World War II, but Congress did not adopt it.

3. Capital consists of a stock wealth, of accumulated assets. It can be viewed as productive capacity (in a real sense)—factories, houses, machinery, inventories of businesses. Capital is also thought of

1/ One school of economic thought associated with the economist Irving Fisher, would define "income" as the worth of what one consumes. By this concept expenditure is a better measure of income than are wages, dividends, and other money receipts. The inflow which most of us think of as income, it is said, is a means to the "coming in" of those things that are really of more basic importance, that is consumption. By this definition, receipts which are saved rather than spent on consumption are not part of income. But consumption paid for by withdrawal from past savings is considered income.

as the money value of the ownership of the tangible physical things. A person's shares of stock, bank accounts, and other intangibles are part of his personal capital. His debts are offsetting items. Much double counting (of both (a) the physical things and also (b) the shares of ownership or the evidence of debt applied to those same things) appears in the casual, customary thinking about capital.

Capital represents a source of income; it is a stock which serves as the origin of a flow through time. Land and buildings represent some forms of real capital. But they are not all. And as an economy develops, other forms, especially machinery, grow in importance. A tax on wealth can be progressive if all types of assets are included, without double counting and with the offsetting of debts.

Saving and Changes in Wealth

The difference between (a) income and (b) expenditure for consumption will be saving (or dissaving). A family that spends (consumes) less than its income has net saving. Persons who spend more than income are net dissavers. The difference in either case represents a change in wealth, plus or minus. Changes in debt are obviously important in calculating a person's or a company's net position.

Land has special characteristics. The quantity is essentially fixed. The price, however, can change. Personal wealth can rise or fall because of the change of price of land even when the characteristics of the land do not change.

Capital will usually produce income whether (a) as real productive capacity, or (b) as shares of stock, bonds, mortgages, bank accounts, and other debts that represent loans made to finance the construction and purchase of equipment. The income will probably be taxed as such under an income tax. However, the relations between capital and income can differ greatly as the yields (by ordinary calculations) vary widely per dollars value of capital. In some cases, notably a house occupied by the owner, the income is a service (the worth of occupancy) rather than a flow of money.

The capital that has been built up can itself constitute a tax base. (a) The house tax and the deeds tax do have such characteristics; taxes on land affect the owner as being a tax on his personal capital. But these taxes do not make up a true tax on personal net wealth because other forms of wealth are not included and debts are not deducted as offsets. (b) Death taxes, even when they apply legally to the transfer of wealth, are in economic reality levies on capital.

They do not destroy physical things. But death taxes do reduce private wealth. The dollars used to pay these taxes are not then available to pay for the creation of new productive capacity. In Taiwan the taxes at death produce only a little revenue.

Economic Effects Will Differ

The directness of income, consumption, or capital taxes can be clear and close, as in personal income taxes and property taxes on a homeowner. Or the relation to the individuals who actually pay can be indirect, hidden, and remote, as in taxes on business companies and property used by them and commodity taxes which are not quoted separately to the consumer.

The choice of what tax bases to use, and how, will influence the actual distribution of tax burdens. The choice will also affect the way the economy operates and grows. For example, the use of spending rather than income as the tax base in fact exempts the amounts saved--and will tend to encourage capital formation somewhat.

Taxes on land have very special characteristics; the amount of land in existence does not depend upon high or low tax, but the price of land will be affected by the amount of tax, with a higher annual tax on

land leading to lower land prices. Reliance upon income as the chief tax base tends to burden production somewhat more than does an equal yield tax on consumption. But the results are less clearly distinguished than sometimes asserted.

Notes on Overlapping of Concepts

The three concepts--income, consumption, and wealth--overlap. Trying to get definitions that are satisfactory for taxation proves to be very difficult. Yet taxes (at high rates) do require sharply defined measures. One thing will fall on one side of a line; something else of no apparent difference will fall on the other side. Popular usage cannot serve to provide the demarcations needed when large amounts of tax are at stake. Major problems of income taxation --for example, depreciation and capital gains and losses--involve distinctions between income and capital. In commodity taxation which seeks to tax consumption, troublesome questions involve drawing lines between consumption goods and capital goods.

The incentives for modifying behavior depend largely upon the level and the differences in tax rates. For the most part, income taxes employ higher rates than do broad-base consumption taxes.

Defining "capital" or "wealth" for purposes of

taxation, if there were desire for a tax explicitly either (a) exempting, or (b) falling on, capital, would be harder than merely saying "accumulated wealth" or "personal net worth." Either concept, however, does convey meaning. Each is much different from land or building alone. We can think of a person's accumulated wealth--presumably the money value of assets (net above debts)--as a base for taxation. The taxes that one can be forced to pay toward the costs of government can rest to some extent upon what one owns regardless of his income and of his income and of his consumption.

A few countries do impose annual taxes(at around one percent or a little more) on some definition of individual of net worth. These take account of debts. These taxes are very different from those of the Republic of China which now fall on land and buildings.

Appendix C

Progression in Taxation

(Portions of this appendix have been adapted from a study which I prepared for another purpose. Time has not permitted me to deal with some aspects of progression as fully as I had hoped.)

The land value and the land value increment taxes have progressive rates. Therefore, in studying them we can benefit from some comments upon progression as such. (I prefer the term "graduation" to avoid an impression that "progress" in the sense of advancement of society is aided by tax rate differentiation. In opening this discussion, let me note that in the U.S. students of taxation are more restrained than in the past in endorsing progression. Problems, disadvantages, and limitations receive more attention. Some of the reasons for caution in supporting progression will appear as we proceed.)

Progression as a goal or principle of taxation is widely accepted. It means that as the thing being taxed--income or consumption or wealth--is larger, the tax becomes increasingly heavy as a percentage of the total. The person with 10,000 pays more than

twice as much as those with 5,000, the one with 20,000 pays more than twice as much as the first one. The amount of tax rises, not in proportion to the size of the income or other base but at a faster rate.

Although the principle has very wide endorsement, one weakness appears at once. We have no way to say how much the differences should be. And then, why? A rate scale of 2,4,5, and 8 is progressive. So is one of 20, 40, 60 and 80. Yet obviously the two are vastly different. Wise tax policy requires more than an acceptance or a rejection of progression as a principle. Any application must be of specific tax rates. And since many widely different scales of rates can be considered, the choice among them should be made in light of the purposes of progression. What objectives are sought in having tax rates that are not uniform over the whole range of what is being taxed?

(Note: One set of reasons deserves more space than I am able to give in the time available. A large but inconclusive literature about the declining utility of income or wealth seeks to provide a justification for tax progression. The marginal dollar of income at NT\$4,000 a month is said to have less utility than the marginal dollars at NT\$3,500. Although this

conclusion probably does seem correct intuitively, scholars find that the reasons usually cited are less convincing than we may expect.))

On goal, and probably the chief one, relates to reasons for sharing the costs of government when tax burdens cannot fall equally on all persons. (All taxes, we should remember always, must really fall on people.) For some reason it may appear desirable that some people pay more toward government expenses than do others--and more than in proportion to income or consumption or wealth. Why? How much? Answers are not clear. One general conclusion, however, is that ordinarily this goal of progression can be served only by a tax on a broad base. Not a single type of income (rents) or consumption (housing) or wealth (land) but all (or almost all) of the related types must be the tax base to get a rational distribution of payment for the costs of government.

What guides or principles can be used to decide upon the unequal sharing of the costs of government? The pragmatic goal of revenue may provide a reason for progression. More revenue can be obtained from graduated taxes. The actual difference in yields can be significant. But in fact the net additional revenue from the progressive features

of a tax may be less than assumed. The amount of tax base actually affected by the progressive portion of a rate schedule may not be so large as assumed. (In personal income taxation a large fraction of the actual, effective progression achieved will often result from the personal exemption. Few taxpayers are much affected by second or third bracket rate, but all who pay are affected by a personal exemption.)

Another goal which appears with high priority in discussions of tax progression, is "fairness." Tax burdens ought to be fair. Difficulty arises, however, in trying to define the concepts--which for tax purposes in American writings are the same--of "equity," "justice," and "fairness" as they apply to the sharing of the costs of government. A foreigner cannot judge the subtle meanings of Chinese language and thinking to decide how closely the ideas match. A brief Summary may help others to understand my views about the progressive features of LVT and LVIT.

(1) On the aspect of fairness there will be agreement. Every taxpayer shall be treated according to legal rules which apply equally to all taxpayers in the same group or class. Fairness requires that there be no prejudice, whether by

accident or design, in the application or administration of the law. Whether the present Chinese system of land taxation comes as close to this goal as reasonably to be expected, I have little basis for judging. On the important element of land valuation, however, it is my impression that you do better than is generally found in the U.S.

(2) "Equal treatment of equals" -- horizontal equity -- is also a principle that will be generally accepted for evaluating taxes and a tax system. Attempts to define "equal treatment" and "equals" lead to debate that ranges from minor controversy about details to serious discussion of just what is truly relevant. Nevertheless, the search for consensus remains important. Taxpayers are justifiably aroused when they discover -- or merely suspect -- that they pay higher taxes than do others who appear to be similarly situated (or even better off).

(3) Perhaps the most difficult questions involve vertical equity. People at different levels of economic well-being pay different amounts toward the costs of government. By general agreement they are expected to do so. But how much of what differences will warrant how much difference in tax? The "average" family with an average income and

average consumption of about NT\$_____ (1971) must in the nature of things, year in and year out, pay roughly an average tax of NT\$_____ (1971) if governments here are to pay for the current level of services. But some families are not even near the average of income. Some must pay more toward the cost of government, some less. What factors will then determine how much, and why, some families must bear higher taxes than do others? In no country, so far as I know, has informed, meaningful public discussion led to open, explicit consensus in answering this question. Few people in the United States (or any other society of which I am familiar) ever really face this issue except vaguely, and probably with large amount of personal bias.

One essential of socially acceptable policy is that the unequal treatment of taxpayers must rest on reasonable, not accidental and irrelevant, bases. For an outsider to suggest guides for China involves risks of misinterpreting the values of the society. Standards accepted elsewhere may, or may not, be appropriate. The fact that the Chinese economy is developing and changing rapidly may suggest that older standards can perhaps be revised in some cases. Both the LVT and LVIT impose

differences in burdens which are, to say the least, less than models of fairness.

(4) Gradualness and continuity in the imposition of any one tax, or a larger system, will help to prevent injustice. One principle that can help in distinguishing what is fair from the unfair relates to gradualness. Big differences in tax, large breaks, big "Jumps" or "jerks" or discontinuities in tax burden, which result from relatively small changes in conditions are more likely to be a source of injustice than of justice. Slight inequalities in personal or business position ought not to create large inequalities in taxes.

A small difference in some condition ought not to make a relatively large difference in tax. If getting on one, rather than the other, side of a line--a legal formality, the wording of a contract, a year or two of age, a few units of some measure of a piece of land or a small change of location--if one of these makes a big difference in tax, the results seem more unjust than just.

Some discontinuities, of course, may be a reasonable price to pay for ease in administration or for some other worthy objective. In general, however, slight differences in conditions ought not to lead to big differences in compulsory payments for

government.

(5) Unearned increments can reasonably be said to justify heavier payments to government than other types of income and wealth. But amounts will be uncertain.

(6) Most Americans seem to accept the view that a "fair sharing" of tax burdens must reflect ability to pay. This latter concept, however, lacks clarity. Although usually identified with the idea that the tax system ought to be progressive, "ability to pay" provides scarcely any concrete guidance for deciding how much more some people (families) "ought" to pay than others.

Proportional taxes, of course, take more from large than from small income (or consumption or landownership or wealth). Total taxes here average about _____ of personal income. A set of taxes that average such burden would take _____ from the family with NT\$30,000 income and NT\$_____ from the one with NT\$90,000 (three times as much). But if the goal is graduated (progressive) burdens, other questions must be answered. For example: What basis is there for deciding how much more in taxes it is fair to demand from the family with an income of NT\$40,000 than from the almost similarly situated family with NT\$38,000, or the very differently

situated family with NT\$70,000 or NT\$90,000? Two persons who firmly favor the--principle of progression as a device for getting fairness may disagree strongly on the desirability of any particular set of tax rates. If rate progression becomes very steep, it beyond some point will probably be unfair by most standards. But when? The answer is not clear.

Another problem arises when more than one basis for graduation is considered. Both consumption and the ownership of wealth can serve. Yet if income is the major basis, fitting one of the others into it will be difficult. If the personal income tax applies progressive rates (6% to 60%) to income from land, is there need in fairness to try to tax the land also on a progressive basis according to gross amount owned in a city? In Taiwan as in the U.S., the personal income tax seems to be much the most logical basis for differentiating burdens so that some people will pay more than others relative to their economic position.

Since most wealth yields income, and since most income (but not all) is used for consumption, taxes on income and on expenditure in a sense also apply indirectly to wealth. Taxes on property are indirectly burdens on income. There are, however,

many cases in which relations are not close. Some property, for example, yields higher income than do other assets with apparently equal market price. Some income is saved, and thus in the year it is received will not be reached by a tax on consumption.

(7) Unequal taxation people who by general agreement ought to be taxed unequally can nevertheless produce injustice or unfairness because the actual amount of inequality of tax may exceed--or fall short of--what will widely be believed to be fair. The legislative process may for some reason, however, fail to correct matters. Some taxes are likely to be generally proportionate and some to have regressive portions. Since for many purposes the total for the system as a whole deserves attention, taking account of all elements should be attempted.

In every economy I know about, information about the actual burdens, leaves much to be desired. But two facts are clear: (a) In Taiwan, the inequality in the taxation of income from additional effort ranges from 0 to 60%. The persons making the effort do have different economic positions. But do such differences justify such great variation in tax? One man works more and keeps it all. The other must turn over to government 60 cents of each additional

dollar. (b) Mr. A may pay 20% of land value increment in tax while Mr. B pays 80%; both may have the same total income, including their increments. Or A may have larger total income than B.

(8) In one basic sense justice means giving each man his "due". Here as in the U.S., I would assume that the forces of the market place provide payments of income which for the most part, are probably worth to others about as much as the services provided. This conclusion will be questioned. The size of the exceptions will depend quite a bit upon the degree of competition. Overall, government here takes--and provides services equal to about--____% of total income. If some people produce much more than others, for whatever reason, is it just that they contribute at least proportionately more toward the common expenses of government? Presumably, yes. But does such a justification for taking more dollars from some people than from others also give a basis for deciding that it is fair to take progressively more dollars. Perhaps so. Views will differ. But there are no grounds known to me to judge how much any such "politically oriented justice" (tax differentiation) can properly offset the "economic justice" of the market economy.

When some people who are not really poor pay

much less than do others of about the same economic position, injustice exists, but may not be seen. The "fair share" would seem to be around the general average, except as special considerations carry weight, such as the exemption of a minimum amount for living from income tax.

A striking exception arises when land values go up because of general forces in the economy. The unearned increment can be large. Here is one convincing reason for imposing heavy taxes which can be justified on grounds of fairness. People whose economic position improves because of general developments in the economy, not as a result of their own effort, can, by reasonable standards of fairness, be taxed relatively heavily.

(9) The attempt to make large discriminations in tax rates and tax burdens gives rise to problems of administration and compliance. Where the search for vertical equity leads, not only to high tax rates but also to big differences in rates, efforts at legal avoidance (and illegal evasion) take on high significance. Present land value and land increment taxes have scales of rates with enough differences, I should think, to create strong pressures of escaping tax.

(10) Some advocates of tax progression support

it because of a belief that reducing economic inequality is socially desirable. Slightly different, the goal may be to prevent the growth of inequality. Fairness may be somewhat pushed aside for impressive, but influential, "social" reasons. (But the person citing "social" goals will probably feel that they also involve fairness.)

The issues involving economic inequality are complex. A personal income tax with effective graduated rates exerts such effects. In some countries another device for reducing the tendency for wealth to build on itself from one generation to the next will be taxes on transfers at death. In Taiwan inheritance taxes are not of large revenue importance, partly, I am told, because there is no gift tax. The LVIT to the extent that it becomes due (as land is sold) reduces private wealth. The LVT will induce the dispersion of ownership of land in a locality; but total wealth of family is not changed by a sale of land (without a LVIT), because the funds received will be available for purchase of other wealth.

Incentives to work and save and to exert initiative will be affected by taxes high enough to do much toward reducing large holdings of wealth. And the real choice becomes, in part, one of "a bigger pie to share" versus "more equal pieces of smaller

pie." In view of the needs for capital all over the world, the "equalizing" arguments should be recognized as conflicting in some respects with goals for economic development. But we do not have a secure basis for judging the size of this conflict.

"Social leveling" and equalitarian influences on tax policy have been prevalent in Great Britain and at times elsewhere, as in the United States in the 1930's.

Regressivity

Much of the true merit of discussions about tax regressivity and progressivity really involves concern for the well-being of the lowest income groups. Compared with either down the prosperous and successful or the search for some objective measure of fairness, a better reason for making tax burdens unequal lies in consideration for those with very little economic power (income or wealth). This guide does not rest on thoughts about fairness, which is so hard to define. Mercy and compassion provide the basis.

Whatever one may think about tax discriminations against those with high incomes or high consumption or large wealth--the almost vindictive attitude on which some people (in America and Europe at least

--I do not know about China) base arguments for graduation of tax rates--we can endorse the aspect of tax progression that avoids putting much tax burden on those at the bottom of the income scale. Not everyone of "low" income can be spared some cost of government if the total outlays are to be as high as is now expected. But the very lowest income families can be freed from more than inevitable burdens.

Humanitarian considerations alone can be highly persuasive in any discussion of keeping down taxes on the lowest income groups. An improvement in the conditions of those in real need is a mark of genuine social progress. Governments make it explicitly a goal of policy. One method of moving toward this objective is a lowering, absolutely or relatively, of taxes on those in greatest need--or not raising their taxes as government spending goes up. Government policy through taxation will try to avoid making conditions worse for those in greatest need. Government should not accentuate serious poverty through taxes (with due allowance, of course, for the effects of government. Spending in benefiting those at the bottom of the economic scale).

An income tax with a personal exemption can accomplish much of this end. The tax can do so with

a flat rate (or even with regressive rates on income above the starting level). The personal exemption is the crucial element. Consumption taxes can also be devised to avoid accentuating the needs of those in poverty. Most important for present purposes, a tax on land values will not in fact make conditions worse for the user, over the long run and certainly not for one who is not prosperous enough to own land.

To repeat: Concern for those in greatest need can provide a guide for the humane, and rational, discrimination in sharing the cost of government. The preferential low rate of LVT for homeowners may perhaps be defended on some such feeling. But we can note that it does not benefit the lowest income groups, who rarely own the house they live in. Moreover, it extends benefits to homeowners whose economic position may be very much above average.

Very high rates of tax--certainly any over 50 percent--will substantially influence the way landowners act. A tax rate of 60% or 80% is simply so great that it, not true economic soundness, is likely to determine decisions. Buying and selling will be discouraged. Tax that might be paid at a lower rate does not become due because owners do not engage

in taxable transactions. Moreover, in a real sense the amount of land made available for best uses will be less than if tax did not reduce the marketability of land.

The incentives to manipulate land transactions will be distorted. Artificial factors will overwhelm, those of basic economic merit. The market in land will be made less effective. It will be less active, less competitive, less efficient in allocating that vitally important resource, urban land. "Excess burden" to the society results. And, as noted earlier, probably there is net revenue loss to the government as compared with the conditions of a lower rate.

My tentative first choice if this form of tax is retained would be a flat rate of about 40%. Next, and almost as desirable would be a two-step scale of 30% and 40% or 40% and 50% (A difference of 10 per centage points is large enough to make a distinction but not so large as to open up inducements for manipulating affairs to anythinglike the present.) For the long-run, as noted earlier, integration with the capital gains portion of the personal income tax would be desirable.

At present, I was told, some transactions which would be mutually beneficial for both buyer and

seller--and presumably for the economy--cannot be concluded because one party will not agree to misrepresentation which the other insists upon to save tax. There results an inequity against the scrupulous and those who for some reason (government agencies) cannot use methods which others are willing to adopt.

A government seeking a temporary boost in revenue could give rate reductions for sales in a year or other limited time.

It is unwise as a matter of general tax policy to leave the determination of a large amount of tax to the taxpayer and to actions under his control. On some aspects no alternative may in fact exist. For example, "realization" for capital gains taxation depends upon the taxpayer, his sale. For this reason the necessity of leaving a crucial action to the control of the taxpayer, the amount of tax to hinge on his decision cannot be so large as if he had no choice. Inequity among taxpayers can be substantial. (Under LVT all pay each year. Under LVIT only those involved in a sale, etc., pay. A few land-owners pay a lot while most pay nothing.)

Since in fact determining the "sale" or current element of the tax base is essentially. A figure (announced current value), part of the tax might be

put on an annual basis. Any property owner with an increment above some figure--perhaps a percentage of 30% of his base--would pay 2% a year. The total of payments, perhaps with interest, could be credited against the tax due at time of sale. Revenue would be more regular. The incentive to delay sale would be less. Owner would be treated more equally year by year.

A study of methods of legal avoidance and illegal evasion would provide more concrete indications of measures which are needed to make the tax more effective.

Greater opportunity might be offered for tax-free (or low-tax) exchange of property. (Discuss if time permits.)

The shifting and incidence of this tax would warrant analysis. Time limits have not permitted me to try to trace through the steps of the various subtilities of shifting of this tax.

Land Prices Can Fall

The longer-run trend of land prices in general will presumably be upward. Everything in experience and logic seems to support the conclusion which is widely held (and support it even for periods when there is no rise in the general price level, no

inflation). No one, however, owns "land" in general but rather specific plots of land. Taiwan includes many parcels of land of widely varying nature. Some may fall in price.

(1) If today a considerable speculative element remains in some land prices, this portion (or part of it) may be squeezed out by one or more force. (Although "speculation" is difficult to define, I refer to an element of price which cannot be supported by the income which would be paid for its use in a free market.) Such results would be hailed as desirable by many Chinese. A psychological change may occur affecting perhaps only some types of property such as old centers of cities. Inflationary expectations (of land) may drop. The effect on some land prices might be significant. The demand for the land could be reduced and the supply increased by a change in the psychology of land price expectations.

(2) Some land in the normal course of events will become less desirable as portions of older localities stagnate and as changes are made in streets and other features. Prices of such plots may then go down, perhaps for many years they will stay below an earlier level. Even though most land prices are rising as an element of normal economic development, exceptions are to be expected as com-

munities charge their character.

A related point can be added. The "normal" rate of long-run rise of land prices in Taiwan will probably be less than may now be rather widely expected. Obviously, I have scarcely any qualifications for judging the expectations of landowners here. But the rapid increases of recent years may have encouraged beliefs that some such (rates of) increases can be continued. For important parts of the land area the past may already have discounted in present land prices much of the real growth of the next few years. If so, the room for price increases of such land is limited even though the general economy does very well.

Two points follow from whatever validity there is in the conclusions above. (1) Budget plans should take care to be realistic in estimating LVIT revenues. (2) Additional importance attaches to keeping valuations up to date. Owners paying LVT should get the proper allowance for any land prices declines which occur. Elementary fairness calls for such actions.

Of course, present land prices include large amounts of increment which have not yet been taxed. There is a tax base of such increments which are yet to be taxed as the property is sold.

Appendix D

The Shifting and Incidence

((Some of this material is adapted from my American Public Finance, 8th ed.))

Judgment about any one tax or a tax system should rest upon knowledge of who really bears the burden. Individuals and businesses will naturally try to shift a tax to others. They will also resist the efforts of others to shift tax burden to them. Generally, tax shifting is possible only through a business relationship, ordinarily when a sale is made.

The possibilities of shifting tax differ greatly from case to case. Final results are not by any means those the ordinary person might expect. Economic analysis of property taxation provides considerable help in understanding the processes and final results. The general reasoning is summarized here. But it needs more modification for the Taiwan situation than I have been able to give. (1) The fact that both LVT and LVIT have progressive rates does require modification of reasoning which rests upon a uniform tax rate. (2) An LVIT is not payable unless

the owner sells the land. He has considerable control over the amount he will pay because he has choice about whether or not to sell a piece of land.

(3) Methods of escape from the higher rates of tax will influence actual results. I am not able to take these results into account in a general analysis.

Durable properties and property rights--land, buildings, machinery, furniture, mortgages, and corporate and municipal securities--may be taxed periodically, most probably on an annual basis, as by LVT and house tax (in contrast to taxes on transfer, as by LVIT and deeds tax). Such an annual tax cannot, of course, be paid in kind out of the property itself. For a rural tax, payment may be made in kind out of the produce. If the property produces a periodic monetary income such as rent or interest, or contributes to the earning of business profit, the tax may be paid out of this income. If the property yields its services directly to the owner without his receiving them in monetary form, as does an owner-occupied house or an auto maintained for pleasure driving, the tax must be paid out of the owner's other income.

Possibilities of shifting a periodic tax on durable properties differ, depending upon: (1) whether the tax applies to all properties or is limited to a speci-

fic type, (2) whether the taxed property is held for personal use or is employed in some business connection, and (3) whether the property is reproducible or nonreproducible.

An owner has no way to shift an annual tax imposed on property commonly held for personal use--chiefly, owner-occupied dwelling houses. His personal ownership and use will involve no business relationship that can enable him to shift the forward or backward to someone else.

Even when the taxed property is rented to a tenant, the owner probably cannot immediately shift a tax increase by raising the rental charge. Some leases, however, do have escalator clauses in which the tenant agrees in advance to pay all or part of any tax increase. Basically, however, the rental charge, like any other price, is established by the interaction of demand for, and supply of, such properties. Neither the demand nor the supply is immediately affected by the change in tax. Hence, the tax cannot affect the rental charge--unless, of course, the pretax rent was less than the maximum the landlord could have obtained; the tax may then prompt him to take fuller advantage of his position.

What happens as there is time to adjust? In tracing the long-term effect of annual taxes on

rented properties, we must distinguish between reproducible and nonreproducible properties. Included under the heading "reproducible" are buildings, machines, and other items which can be replaced by identical or similar properties created by human effort.^{1/} Natural resources, patent rights, and historic buildings are examples of nonreproducible properties.

^{1/} In economic treatises, land is generally considered nonreproducible, but this is not strictly true. Farming land comparable with existing parcels can often be produced at the expense of cutting timber, draining swamps, levelling hillsides, irrigating arid regions, and applying fertilizer. Building sites comparable with existing parcels can often be created by cutting down hills, grading or filling uneven lots, and constructing streets and transit facilities. The distinction between land and reproducible capital properties is therefore relative rather than absolute. This consideration must be borne in mind as an important qualification of the conclusions developed here. This caution is also important when the argument is extended to other natural resources. Exploration itself can be costly and risky but yield results.

Let us assume a fixed supply of land suitable for given uses. A periodic tax on these properties reduces the net income (rents) derived from them. (Gross rent 1,000, tax 100, net 900. Tax increases to 125; nothing about the tax increase makes the user able and willing to pay more rent, so the gross remains at 1,000. The net becomes 875.) Hence, as we shall see, the tax increase reduces the capitalized value of the land. But, no matter how long the tax lasts, it cannot alter supply nor affect demand.^{2/} Barring unusual contractual relationships, the long-term and the immediate effects of the tax remain the same--the tax is not shifted.^{3/}

Or, more briefly, the nonshiftability of a tax on rented land can be argued on the basis of the "economic surplus" doctrine. The value of a parcel of land is normally a capitalization of its expected net yield (rental). As tax on the land, therefore, is equivalent to a tax on the yield rent. Pure rent is an "economic surplus" (as defined strictly as a payment which is not needed to bring a resource into existence and make it available for production). A tax on economic surplus cannot be shifted. Hence, a tax on land cannot be shifted by the owner to the user.

But if a durable property subject to renting is

reproducible--office space or an apartment, for house tax, will eventually affect the quantity provided. Because the net return from the property is reduced by the amount of the tax, such a building becomes less profitable than properties not subject

2/ If the higher taxes are used for better governmental services, the community will be more attractive than otherwise. Users of land may be willing and able to pay more rent. Businesses, for example, may be able to earn more from better sales or lower costs.

3/ If the theory of rents, instead of the theory of supply and demand, is used as a first premise, the same conclusion can be reached with respect to a tax on rented land. The rent chargeable for any parcel of land is determined by the excess of its productivity over marginal land. Because the value of land, speculative variations aside, is the capitalization of its expected annual net rental, any truly marginal land has no value to be subjected to taxation. If the owners of better than marginal land attempt to add their taxes to the rental charges, the resulting gross rentals sought would exceed the differential productivity of the plots over marginal land. Tenants would desert the otherwise better (supramarginal) properties for marginal land. To win them back, the landlords must reduce rentals, absorbing the tax themselves--perhaps giving up ownership.

to similar taxation. The flows of new investment capital will then reflect the impairment of expected net return.^{4/} New funds will tend to avoid the taxed property and seek other, more remunerative placement. Old properties wear out and are not replaced. Or if demand for the properties in question is growing, fewer new ones are produced to meet the rising demand. Under the circumstances, bids for the properties must rise--prospective tenants must eventually offer higher rentals. The increased rentals will come to cover the tax, and the net after-tax income derived from the taxed buildings represents a rate of return equal to that yielded by other investments not subject to this tax. Though the higher rental, the tax on structures has finally been shifted by landlords to tenants.

Time needed for shifting depends upon five factors in addition to the inevitable frictions of the market place: (1) the average life of the properties involved; (2) whether the current supply was all

^{4/} In the U.S. the differences in tax rates among localities will be taken into account. In Taiwan this result is not to be expected because of the general uniformity of rate. But the absence of a tax on machinery equal to the tax on buildings may tend to produce some slight adjustment.

newly created or whether there was an appreciable number on the point of disappearing from the market; (3) whether demand for the properties is markedly inelastic or relatively elastic, (4) whether demand is decreasing, static, or increasing; and (5) whether some of the tax may for a time be shifted backward to specialized labor and capital equipment. Depending upon the combination of these factors, the process of shifting property taxes on buildings from landlords to tenants may take a relatively long or short interval. In a rapidly growing community, a few house tax might be shifted to occupants within a year or so. In a community which had achieved full growth and has a good supply of rather new houses, a tax increase on buildings might not become fully embodied in rents for several years.

When reproducible property subject to periodic tax is used for business purposes, the tax on buildings (not land) will be incorporated into the prices of articles or services produced through the use of a taxed property. The tax is a cost which must be covered if the company's productive capacity is to be preserved. Marginal plant, which will not support higher costs, will be abandoned or not replaced. Investment will tend to shift to activities with better after-tax prospects. Prices of com-

modities or services produced by use of the taxed property will rise because of the resulting reduction of output. Although "business" may write the tax checks to the government, the consumers of the firms' products eventually shoulder the burden. The full effects on consumer prices of such a tax, however, will not be felt immediately because the adjustment of productive capacity takes time.

When analysis of the shifting of such a property tax is pushed further, it reveals that the resulting flow of some capital to untaxed uses will reduce the yields available in such uses. The owners of investments in such lines will find yields per dollar declining. Thus, the tax on reproducible capital becomes to some extent a more generalized levy on all returns to new capital investment through the economy. So many factors, however, also affect the supply and demand for capital--and therefore the yields--that the net influence of property taxation will not be fully identifiable.

Capitalization

A parcel of land or other durable property yields a stream of services to an owner who employs it for his personal wants or a sequence of rent receipts to a landlord who leases it to a tenant. Partly off-

setting these receipts are costs of repairs and allowance for depreciation or obsolescence. Through the process known as capitalization, the remaining *net service or rental values (as expected over the future)* determine the capital value of the property.^{5/}

At any time, the value of a piece of land or a durable property is the sum of this year's net service or rent receipts, plus next year's expected net receipts discounted at the current rate of return on capital to allow for postponement, and so on, to the point where the discount for postponement balances the value of a year's net service or rents. The formula for determining the capital value of an asset with perpetual life is

$$\text{Price} = \frac{\text{Expected permanent annual net income}}{\text{Rate of interest}}$$

- ^{5/} No single word--returns, benefits, income, services, and receipts--quite covers every element which should be taken into account. Benefit may be best. Often a significant element in the case of land is the hope for a rise in price. A speculative element can exert great influence on property values. And wide differences in views about the future of a region, area, plot, industry, or other element can affect what men will offer for land other properties.

A piece of land expected to bring, net, \$1,000 a year permanently will, if the going rate of interest in the market 10 per cent, have a capital value of \$10,000. In other words, \$10,000 is the amount which if invested under conditions prevailing at the time will produce a net yield as much as the land. If the appropriate interest rate is 8 per cent, the present capital worth is \$12,500. To repeat, the value of a durable property is the capitalization of its expected annual net yield at the current rate of return on capital (the rate being one which allows "appropriately" for risk, including speculative prospects.)

Whenever, or for such time as a tax on a durable property cannot be shifted, it obviously diminishes the net value of the flow of rents or other benefits. And the capitalized value of these annual net services or rents--or, in other words, the capital value of the property in question--is proportionately reduced. In other words, to the extent that a periodic tax on land and other durable properties is not shifted (usually to consumers), it is capitalized as a reduction in the present value of the land and properties.6/

Tax capitalization is permanent in the case of properties held personally and also for land. In the

case of buildings and other reproducible properties, where the impossibility of shifting the tax is only temporary, the tax capitalization diminishes over time as the flows of new capital funds *permit a shifting* of the tax to users or customers.

When a property subjected to a nonshiftable tax is sold, the purchaser naturally takes the tax into consideration in the price he offers. In calculating the expected net value of the services or rents of the property, his offer will be lower by the capitalized amount of the tax. Thus, the purchaser "buys himself free." The capitalized future burdens of

- 6/ A government subsidy to the owner or user of land, such as is paid to some U.S. farmers, has the opposite effect. To the extent that it is believed to be permanent, it will be reflected in a higher price of the land. The owner of the land when the subsidy becomes effective gets the capitalized value. Further operators receive no benefit from the annual subsidy because operators receive no benefit from the annual subsidy because they must pay more to get the use of the land. This result accounts for some of the frustration and failure of U.S. aids to farmers. As time passes, less and less of the annual benefits paid really help the farm operator; but to remove them would hurt him because he would generally still need to carry the costs of land prices which were based on the expectation that the subsidy would continue.

the tax fall upon the owner at the time the tax was imposed. This fact provides a reason for moderation in raising Taiwan's LVT except as other forces are raising land prices. If the land tax could rise in line with conditions producing higher land prices, the government would in effect capture the values. (No one should expect to be able to bring about any exact matching of higher LVT and capitalization with forces in the land market.) No "unearned increment" would result for owners. The increasing amounts paid by users would go to government.

Where tax rates are not uniform on all property--as in Taiwan where LVT rates range from 0.7% to 7% the results cannot be predicted so easily. The smaller the area imposing a tax which is different from the taxes of others, the greater are the chances of capitalization. The reason is that investors can more easily take account of alternatives which are available in other jurisdictions. If one county were to impose a land tax of 3.0% when all the rest of the Island had a 1.5% rate, the prices of land in the first county would drop (ignoring the effects of absentee tax in discouraging inter-community flow of capital for investment in land. If the whole Island were to raise the rate from 1% to 3%, more time would be required for full capitalization; but numer-

ous factors in the markets for capital (interest rates) and land would exert influence.

Differences in the benefits of governmental services paid for by any differences in local taxes would have to be considered. The results of the spending might largely offset the higher taxes.

One highly important result is that most of the land value tax today is no true burden on the present owner or user. When he agreed on the terms of purchase, the price he paid took account of the then existing tax. Having "bought himself free of the burden," he then pays the annual tax without really suffering, compared with what he would have paid for the property if the tax had not existed or had been lower at time of purchase.

Major Conclusions of Land Tax Study

August 24, 1971

Professor C. Lowell Harriss

1. If more revenue is needed for (local) government spending, land values have the economic ability to provide substantial additions over the longer run.

The economic merits of land value taxation are strong, beyond the reasons which support (high) taxes on increments.

2. The annual land value tax could be developed into a more important revenue source.
 - a. Progressive rates of this tax do not seem to me desirable except for a preferential rate (now 0.7%) for homeowners (" acceptable " more on purely economic grounds) and perhaps those for industry and greenbelt.
 - (i) The incentive to fragmentation of urban holdings is undesirable.
 - (ii) The tax burden results of this progression bear no relation to rational bases for tax progression.

- b. A flat rate of about 2% would now yield the same total revenue. Gradually, a move to higher general rates would be possible to meet revenue needs. Consideration might be given to allowing each local government to adjust its rate somewhat.
 - c. The valuations used should be as near the current market prices as possible (with the alternative of 80%).
 - d. Keep the land tax separate from that on buildings.
 - e. Try to avoid complexities; encourage simplification.
 - (i) If progressive rates are not abandoned, some revision of the "progressive" starting value system is desirable.
 - (ii) The penalty on vacant land seems more likely to have bad than good results.
 - (iii) The penalty on absentee owners also appears undesirable.
 - (iv) To control land use for various specific goals, tax provisions cannot possibly do the job of direct regulations.
3. The land value increment tax
- a. Should apply over as large an area as possible.

- b. The present range of rates--20% to 80%--should be replaced by (i) a flat rate, perhaps 40%, or (ii) a two-rate schedule starting around 30% and not reaching over 50%.
- c. Eventually, this tax should probably be blended into general capital gains features of the personal income tax.

Valuations are crucial. I would strongly urge that valuations be kept up-to-date by continuing revision. Frequent adjustments even on an approximate basis, are better than the use of obsolete figures.

- 5. A tax on property transfers as high as $7\frac{1}{2}\%$ --deeds tax--must interfere harmfully with the real estate market. Rate reduction is desirable, with revenue presumably to be made up by a higher rate of land value tax.