California's Governor Elect
By Dr. Mason Gaffney

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INSIGHTS

by Dr. Mason Gaffney, Riverside, CA
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CALIFORNIA'S GOVERNOR-ELECT

For better or worse, California has recalled its governor and elected Arnold Schwarzenegger (A.S.) to replace him. A.S. has revealed no specifics of how he will stanch our deficit. He campaigned on generalities: he is against taxes, against waste in government, against measures to rein in vehicle use, and nostalgic about the good old days when Governor Pat Brown was spending heavily on roads and water projects. No one seems sure how he will connect the dots. After his first visit to Sacramento last week, he seemed not sure, either.

His choice of advisors, however, tells us A.S. will repeat Pete Wilson's performance from the early 1990s. Chief of Staff Patricia Clarey is a good soldier from Wilson's old staff; Auditor Donna Arduin is from Jeb Bush's Florida. The gurus who set the doctrinal tone give the clearest hints: they are neo-classical economists of deepest dye. These are advisors George Shultz and Michael Boskin from the Hoover Institution. Economics, to them, is a set of dismal choices. California's choice is to cut public services, or lose business and jobs. That is what they told Wilson in 1994. All taxes are the same, always "burdens," always driving away "business."

In 1994, Wilson appointed Shultz and Boskin heads of his "Task Force on California Tax Reform and Reduction." They "urged" a 15% cut in income taxes, personal and corporate. Biggest cuts would be for corporations, and the highest brackets. Boskin said "savings to business are crucial to the State's recovery." Shultz said it will "spur job creation," and "make California more competitive." Wilson endorsed the report, to make California "a friendlier place for taxpayers." Other usual suspects like The State Chamber of Commerce jumped right on board, to "stimulate the economy." It could have been a dress rehearsal for G.W. Bush in Washington.

They promised it would increase revenues, on the Laffer-curve hypothesis. Failing that, they would cut "waste in government," that perpetual whipping boy. On the last matter, they stifled two important points. First, in 1978 critics of Prop. 13 asked Howard Jarvis how the public schools and local governments could survive without the property tax. "Let the damn s.o.b's in Sacramento figure it out, that's what you pay the b.....ds for," came the answer in Jarvis-speak. They figured it out, all right: they raised sales and income and business taxes, to funnel funds to localities and schools. Naturally, state taxes rose without any visible rise in state services. Now the Jarvisites, including A.S.'s advisor Jon Coupal, cite this as waste in Sacramento.

Second, most taxes come out of the social surplus, hence sooner or later out of land rents. Most landowners, wrote Adam Smith, are too "indolent" to be fully aware of that, so they oppose land taxes. Later, as the truth seeps in, they come to oppose all taxes. Wasteful public spending is bad, but the part not wasted is spent in the public interest. Jarvis told us that fire-fighters are just hogs like teachers, with their "noses in the public trough," but today, like Kipling's Tommy Atkins, "it's savior of 'is country when the guns begin to shoot." Today, no one even expects that any part of the rents taken privately should be spent in the public interest. Luxurious waste by private rent-takers is seen as a natural right, free of social obligations. Thus far have we come from the feudal coupling of social obligations with private rents. Add to this the notion that widows and other poor people own all the land, so any tax is regressive.

Boskin and Shultz, posing their dismal choice for California, dismissed by silence that we can raise needed revenues while also spurring job creation and stimulating the economy. It is simple: restore that part of the property tax that falls on land, while continuing to cap the rate on buildings. Attorney Charles Haughey has drafted a simple amendment to Prop. 13 that accomplishes this by changing just a few words here and there. Boskin and Shultz's silence is not from ignorance. Boskin was the protege of George Break, a member of Schalkenbach's Committee on Taxation, Resources, and Economic Development (TRED). He is the colleague of Hoover staffer Charles McLure, another TRED member, and of Milton Friedman who has (reluctantly and patronizingly) muttered a few good words about taxing land values. It is rather that the Georgist message gets filtered out.

How does that happen? Pete Wilson, when Governor, was thick with major landowners, who are also major political contributors. Wilson as Governor used one of the residences of Donald Bren, owner of the Irvine Co., for official meetings. Irvine has owned for years about 1/5 of Orange County, and its interest has ever been to maximize the value of its lands. It is not hard to fathom why A.S. told Warren Buffet to do 500 pushups the moment Buffet suggested reviving property taxation.

It is also alleged that land values are too small to support government. Let us test that idea. In 2003, at the current rate, there will be about 15,000 "confirmed" sales of owner-occupied urban California residences at prices over $1 million. That is from DataQuick, a standard source of current real estate data. 15,000 is about 2.7% of all confirmed sales. Some of those go much higher. The mean is probably over $2m.

Turnover of costlier homes is lower than that of ordinary homes. (For example, turnover of existing homes is 30% greater in Riverside County, with lower values, than in Orange County, with higher values.) 2% a year is a fair (continued on page 8)

guess at the turnover of homes valued at $1 million or more. If so, there are 50 x 15,000, or 750,000 homes in California valued at a mean $2 millions. Their aggregate value is 750,000 x $2 million = $1.5 trillions.

These are not large buildings: they average 2864 s.f., with 4 bdrms, 3 baths. In the north end of Sta. Monica, a vacant lot alone is over $1m. They are not new buildings: only 9% are new. It's the land that makes them worth so much.

A tax of 1% on that value would yield $15 billions a year. That's from only 2.7% of the urban homes in Calif. The data exclude many sales, country manors, for example. Some well-known lands thus excluded are the Lucas compound and the Pritzker family compound in Marin; San Simeon; the Reagan Ranch and similar holdings in the northern half of Sta. Barbara County; fashionable winery properties in choice valleys statewide; the Chandler family's Tejon Ranch; the 200,000 acres of James Boswell in the Tulare Lake Basin; etc.

There is also the other 97.3% of urban owner-occupied residential real estate. A lot of it is just under $1 million a pop. In Marin County, the median sales price of owner-occupied single-family homes was $700,000 when last seen, and rising. The mean is always higher than the median. Some L.A. County cities with median values just under $1 million include San Marino, Bel Air, Westwood, Brentwood, La Canada, Calabasas, and others. There is also all the other land: commercial, industrial, farm, forest, etc., which is 60% of the assessed property value in California, and a much higher fraction of the real value because it is so egregiously underassessed.

Ten percent of the residential units are vacant. Vacancy rates are especially high in beach cities with resort qualities and very high prices. These also include "beach, yacht and business" cities like Newport Beach.

A high fraction of California real estate is absentee owned. The Sultan of Brunei, for example, owns several houses and sites in Beverly Hills and Bel Air. California's official Legislative Analyst, the highly respected William Hamm, estimated in 1978 that over fifty per cent of the value of taxable property in California was absentee-owned. This is such a bold, bare, and enormous fact that it is hard to understand how Californians have been misled into resisting the urge to levy land taxes on all this foreign wealth. They may be put off by the argument that they need to attract outside capital, but that carries no weight when considering the large percentage of this property which is land value, and which may be taxed separately from buildings.

Some half of any reduction in California property taxes leaks to out-of-state owners. Nor is this the only leakage. Net federal income tax payments have risen because sales and nuisance taxes raised to replace lost property taxes are not deductible. Sales of local general obligation bonds have stopped and will stay stopped. Revenue bonds are sold instead, with higher interest rates. Fire insurance rates must rise. Private spending, even by local landowners, has a higher propensity to import than public spending that goes for policemen, firemen, teachers, local contractors, and so on.

This substantial leakage of economic base results in multiple declines in state income. Cities love to commission "economic base" studies, and a small industry of moonlighting economists love to perform them, usually to rationalize subsidizing some transnational conglomerate to put in a branch plant. They use canned "input-output" models to show how every dollar invested generates $2-3 of induced investment locally. Yet no one has seized on this obvious case to show that local property taxes, substituted for absentee rent payments, creates multiple increases in local income. The whole intellectual apparatus is dominated by absentee investors and used for their benefit.

Many rents may be taxed in other ways. Georgists have long noted that parking meters are a way of collecting rent for use of public land, but they are pikers when it comes to estimating the value thereof. Donald Shoup, a UCLA professor, estimates the value of street parking, if properly priced, as enough to replace the entire property tax.

Parking, however, is less than half the story. Vehicles also use public space when they are moving, often bumper-to-bumper in heavy traffic. Bridge, tunnel and ferry tolls reflect this obvious fact, and yet even most Georgists resist the obvious logical extension of the principle: taxes on vehicles and fuels are a kind of rough "land tax on wheels." The revenue potentials are breathtaking. Auto dealers, of course, spearhead the opposition. Observe how many acres each dealership preempts, and you will understand how they make so much money to brainwash the public into rejecting such taxes, along, of course, with conventional property taxes on their land.

Many valuable land resources are held by license, rather than title, and escape the property tax almost entirely. Licenses to divert water are an obvious case, and worth enough to replace billions of dollars of sales and income taxes. More on this, and the recent transfer of Colorado River water to San Diego, will appear in the next installment of Insights.

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