Proposition 13 and the Decline of California: Excerpt from 'Property Tax Reform in the Big Picture'

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Proposition 13 and the Decline of California

Excerpt from:

"Property Tax Reform in the Big Picture"

Mason Gaffney

Paper Delivered at the Conference on Land, Wealth, and Poverty

The Jerome Levy Institute, November 3, 1995

What happens when a state radically slashes its property tax? Michiganders are saying they must wait and see, but there is no need for that: California can show you seventeen years of experience. To read your future, just study our past. Here is what has happened since California passed Proposition 13 in 1978.

The obvious direct results have been to cut public services, raise other taxes, and lose credit rating. Our school support fell from No. 5 nationally to No. 40 in 1985 when last seen, still falling. County road maintenance is down to where my county (Riverside) is repaving its roads at an annual rate of once every 130 years. Once in twenty years is recommended here, and up north you generally need higher frequency. You can't just build infrastructure and then stop paying for it; it's a perpetual commitment. Thanks to urban sprawl, a high fraction of our population now depends on these county roads.

In 1978 we had a surplus in Sacramento. Since then we have raised business taxes, income taxes, sales taxes, and gas taxes, but go broke every June. Now our state bond rating is last among the states. One of our richest counties (Orange) has gone bankrupt; Los Angeles is on the brink of it, saving itself by closing emergency rooms and hospitals that serve as a last resort for the uninsured poor.

The private sector is doing badly, too. Raising income taxes, business taxes, and sales taxes is no way to stimulate an economy; they are all a drag on work and enterprise. Our income per capita was down from No. 7 to No. 12 among the states by 1992, then fell some more. From 1992-1994, California was one of three states where median household income fell. Our unemployment rate is 9%, 50% higher than the national mean of 6%. Our poverty rate is 18%, compared to 14.5% nationally. Not surprisingly, therefore, the only government function that grows now is building and operating prisons. One of our few rebounding industries is cinema, the art of escaping from reality: we excel at that. Another thriving activity is that of auctioning off used machinery for export to the east.

In 1993 there was net outmigration (including international migration) from this state that has symbolized American growth since time immemorial. It is unheard of: 426,000 people were lost, nearly 2% of the population. This is a watershed change: imagine of all states California,

America's trendsetter, our El Dorado, the Golden State, our Horn of Plenty, the safety valve for job-seekers and retirees and entrepreneurs from everywhere, the end of the rainbow, losing population! It's almost enough to make a person click off the tube and think.

The fall of our income per capita is greater than appears from the purely monetary measure. Real pay has fallen more, because of the drastic rise of shelter prices. In San Francisco, shelter takes 50% of the median income, with many other cities, especially coastal ones, not far behind. It is unusual to find livable quarters for less than $600/mo. The median home price rose 163% during the 1980s to $258,000 (remember that is just the *median*—the mean is higher). These rises are part of the cost of living of all renters and new buyers, a part not fully incorporated in standard CPI measures (for various unworthy reasons too technical to open up now).

Some cities are in desperate straits. San Bernardino in 1976 was chosen an "All-America City, a City on the Go." It went, all right: today, 40% of its people are on welfare.

California has always been earthquake country, but has always renewed itself, routinely. It was different after the Northridge quake in the San Fernando Valley, January 1994. This is the upper-middle neighborhood of Los Angeles, but now large pockets of ruined buildings remain, unreconstructed, inhabited only by vagrants and criminals: an instant Bronx West. These blighted sections, ominous portents, spread more blight around them.

It should give one pause. It is, however, if you think about it, the expectable result of what the voters did. They turned property from a functional concept into a sacred one; from a commission to be enterprising, hire people, produce goods, and pay taxes into a welfare entitlement. They rejected the concept of a tax on inert wealth in favor of the rival concept of taxing liquidity and cash flow. The predictable result is to inhibit economic activity, and encourage holding wealth inert and stagnant.

We had a construction boom in the 1980s, but it was not healthy. It was marked by extreme sprawl, and extreme instability. Downtown L.A. was to become a great new financial capital, but now has nearly the highest office vacancy rate in the United States, with of course a high rate of builder bankruptcies. Speculative builders were led on to overbuild, in part, by anticipated higher land rents and prices. This Lorelei effect was magnified by national income tax provisions luring on speculative builders, but we have to ask why California fell harder than other states, even with the object lessons of the oil states in clear view.

David Shulman tersely summarized the distributive effects of Prop. 13 as he left us for Salomon Brothers in Manhattan: "It breached the social compact." Alienation is the result, and the Rodney King riots, arson, and looting are the results of alienation. True, the Watts riots preceded Prop. 13, but they were part of a national epidemic. By 1967 there were riots with arson and looting in seventy or more American cities. The Rodney King riots were endemic to California, and spread over a much wider area of Los Angeles than the Watts riots did. The looters and arsonists were not all black, and the targets were not all white, but mainly Korean-Americans who just happened to be there minding their stores.

Conventional wisdom blames our bust on the end of the Cold War. Surely that is a factor, but as a causal explanation it is too pat, too easy, and ahistorical. Compare today with 1945. Los Angeles' economy depended much more on the Hot War, 1940-1945, than it ever did on the Cold War. Los Angeles' wartime boom had swelled its population as no other great city, 1940-1945. After 1945 the United States pulled the plug on defense spending, more than today. Jane Jacobs,

in *The Economy of Cities*, tells us what happened to military spending in Los Angeles after 1945: It lost three-fourths of its aircraft workers and 80% of its shipbuilders. It lost its military and naval overseas supply and replacement businesses. Troops stopped funneling through. It got worse: petroleum and cinema and citrus, its traditional exports, all declined.

Pundits then forecast a regional collapse. Yet, regardless, Los Angeles never collapsed, nor missed a beat. The wartime immigrants stayed put here. They formed creative, innovative small businesses in large numbers, giving L.A. its deserved reputation for having the most dynamic, flexible, adaptable industrial base in the nation. Besides exporting goods, L.A. also became more self-contained, providing itself with more of the goods it previously imported. How could this be?

One-eighth of all new businesses started in the United States were in L.A., 1945-1950. These were small, creative, flexible, and too varied to classify. No Linnaeus could sort them in conventional categories: the new Angelenos simply stayed here and started producing everything for themselves, some things previously imported, and others never seen before. Eastern firms established branch plants here. Top eastern students came to California's great university system, and stayed behind to make careers and jobs here. There was a kind of regional "El Dorado Effect," as demand and supply grew together, and growing local demand allowed for economies of scale serving local markets. Food and shelter were cheap and abundant. Land for business was accessible, providing a basis for the whole self-contained phenomenon. A "continental tilt" developed in both interest rates and wage rates, drawing in eastern capital and labor.

Why is that not happening today, 1995? An invisible, pervasive change is Prop. 13, which makes it possible to hold land at negligible tax cost. In 1945 land was taxed at 3% every year, building a fire under holdouts to turn their land to use. Today that same tax cost is well below 1%. Using Gwartney's Rule of Thumb (see below under B,1), it is about one-eighth of 1%: a rate of 1% applied to one-eighth of the true value.

Landowners are taxed now only if they use their land to hire people and produce something useful. Then they meet the drag of our high business and employment and sales taxes, necessitated by the fall of property taxes. A handful of oligopolistic landowners control most of the market; small businesses are squeezed out. This helps us segue from being at the cutting edge of industrial progress to a Third World economy—from the NH model to the AL model—with little relief in sight.

What was different then? One obvious difference was the high property tax dependence in 1945, and the lower burdens of sales tax, business tax, and income tax. We not only had high property tax rates, they were more focused on land then than now. California was more hospitable to Georgist thinking than perhaps any other state then, shown by its long run of Georgist political action in the prior thirty years. Several states had "single-tax" movements and initiatives, 1910-1914, but most of them petered out. In California they continued through 1924, and then popped up again in 1934-1938. Even while "losing," such campaigns raised consciousness of the issue to such a degree that assessors were focusing more attention on land. Thus, in California, 1917, tax valuers focused on land value so much that it constituted 72% of the assessment roll for property taxation—a much higher fraction than today. This became the California tradition.

In 1934 the "EPIC" campaign of Upton Sinclair included a strong Georgist element—he proposed to set up new factories on idle land. Meantime, Jackson Ralston was pushing a purer

land tax initiative, 1934-1938. Ralston lost, but the mere existence of such political action in California, when the movement was torpid elsewhere, tells us a lot. It reveals a large matrix of supportive voters and workers to whom politicians (including tax assessors) would naturally respond by focusing on land assessments.

California displayed amazing growth up to 1978, and the resilience to shrug off the loss of war industries after 1945 and still grow "explosively" (as Jane Jacobs put it). After 1978 we have a string of reverses. The timing, along with a priori causative analysis, plus various direct observations too numerous for this time slot, support an hypothesis that the reverses were aggravated by Prop. 13. Michigan, be warned of our lot, and learn about taxes from us: "This Could Happen to You."