The Property Tax and Intergovernmental Relations
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See pp. 15-22, interpreting 1962 Census of Govts

"The Property Tax and Intergovernmental Relations"

Remarks by Mason Gaffney to the President's Advisory Commission on Intergovernmental Relations, September 14, 1972

I have four points: we do not need property tax relief; we do need assessment reform; we do need to shift the property tax in part to the state level; and we do need to convert the general property tax into a tax on site value.

I. We do not need property tax relief.

A. To speak of property tax "relief" is tendentious wording. We are not discussing tax relief but tax substitution. Property tax relief is sales tax aggravation, or income tax or payroll tax aggravation. Tax relief may be secured by making cities more compact, economical and efficient; by cutting out boondoggling in public works and highways; by increasing employment and cutting the welfare rolls; by reducing military outlays; and so on. Insofar as tax policy may contribute to these ends it will indeed bring true tax relief, and one reason for favoring the site value approach to property taxation is to make cities more efficient and cut per capita social overhead costs. There is genuine tax relief.

B. We need to view the property tax in the context of a total tax system. The personal income tax is larger, with property income well sheltered from the full impact of the rates so that payrolls bear the main brunt. The other payroll tax, the one vaguely connected with social security, is larger -- and not

deductible, as property taxes are, from taxable income. The sum of all excise taxes is certainly larger. Roger Freeman has given us the figures on how small a share of the total tax burden is comprised by $45 billions paid in property taxes.

The other taxes are all activity-based -- they are based on some act, usually constructive, of enterprise, management, turnover, consumption, and above all labor. The property tax is the only one based on passively owning, as opposed to doing. I submit that enterprise and labor are worth more to a nation than inert wealth. The property tax activates wealth. That is especially true of the part of the tax that falls on land -- another reason, of course, for favoring the site value approach. In lesser measure, and in the short run, it is also true of the part that falls on capital, especially in cartelized industries which are characterized by excess capacity.

There are those who think the property tax cannot be progressive because it is simply proportional to value, without regard to size of ownership. However, a common tax rate applied to all property, regardless of the owner's total wealth, tends to be progressive for the basic reason that the use of property is generally regressive. That is, larger holdings are combined with less labor, and produce less gross volume, per dollar of wealth, than smaller properties do. This follows as an inevitable result of the tendency of interest rates to be regressive -- the poor and the small pay more to hire capital.

Wage rates on the other hand tend to be progressive -- the rich pay more. So larger firms are more capital-intensive and land and resource-intensive; smaller firms are more labor-intensive. Larger capitals turn over more slowly; smaller ones more rapidly, thus generating more activity and volume per dollar of taxable property.

Carrying this a step farther, larger ownerships tend to be higher on land relative to capital. I have some data from the 1940 Census of Agriculture which illustrate this generality in extreme form. I am submitting them for the Commission staff, along with a collection of like data from other sources. This is another reason for favoring the site value approach to property taxation.

C. On welfare grounds, property income should be taxed at a higher rate than labor income.

1. Wealth itself is part of "ability to pay," regardless of current income. Wealth implies the ability to liquidate, and, to avoid that, the ability to borrow, for wealth is the basis of credit ratings. In respect to the elderly, wealth is a reasonable basis for expecting one's heirs to cover his or her real estate taxes. These data we see on the retired elderly seem to be premised on the idea that children do not care for their aged parents, an unrealistic assumption, the more so when the parents are holding property for these same children. I invite your attention to the fact that many elderly property owners avoid selling

homes and farms which are much too large for them, specifically to avoid payment of capital gains taxes. As you know, when property changes hands at death the entire capital gain up to that date escapes income tax, 100%. The heir begins with a new stepped-up basis, the value at death.

The principle that wealth is part of ability to pay is quite general, but in respect to the elderly specifically, note that some liquidation of wealth during retirement years is an entirely normal and reasonable part of the life cycle. It is unreasonable and misleading to judge the relative burden on the aged in terms of current income alone. The aged, in anticipation of death, have a much greater ability to liquidate than others, and a much greater security in terms of support from middle-aged children. Most of us can supply illustrations from our own families.

In passing, let me note that an exaggerated concern to give special privileges to the elderly and the retired is part of the put-them-on-the-shelf syndrome toward the aged which should soon go the way of white racism and male chauvinism. The aged, like the rest of us, do not need to be patronized, they need the opportunity to be useful. Those that become welfare cases should be treated by the welfare system on an impartial basis, without special favor to property owners. To use property tax relief as a substitute for welfare is to distribute welfare in proportion to wealth, surely an odd notion. To shape the entire property tax for the benefit of one special age and class of people would

not, on its face, be well balanced policy-making.

2. Property income of a given amount puts one on a higher plane of well-being or welfare than labor income of the same amount, because one needn't work for it. $15,000 a year earned by working long shifts in a coal mine with black lung disease is not the same as $15,000 a year from property with a life of ease, (plus the option of living off the wealth, or banking or parlaying it). The industrial accident and disease toll each year is frightful. So is the highway accident toll, most of which occurs during commutation. Income is not income, in terms of welfare: it depends on what you have to do to get it. Before 1942, there was an earned-income credit in the personal income tax in recognition of this. Today, income from labor is taxed much higher than income from property, because tax shelters and loopholes mainly involve property ownership. The main counterpoise to this is the property tax.

3. The property tax asserts a general public equity in land under private tenure. This is a necessary counterpart to a system in which some of our land is committed to private individual tenure. Most of the United States was public domain not long ago, -- not long in the perspective of history. Everyone had an equal claim. Land was turned to private tenure in order that the land be put to a higher use than is possible or likely under direct public administration. It is not practical to give everyone an equal share. To compensate those who are left out,

land in private tenure has been made subject to the property tax. The tax asserts the equity of non-holders.

This was all darkened over when the states relinquished the property tax to localities, which are not much interested in protecting the equity of the landless, especially as the latter become increasingly migratory. But it was at the same time reaffirmed by the states' requiring localities to provide public schools, and leaving the school districts entirely dependent on the property tax. The right of every child to a free education is a form of social dividend, a way in which part of property income is shared with each citizen as a birthright.

This basic relationship and principle is forgotten in the catchphrase that "Property should pay for services to property, but not for services to people." Property should pay for services to people because all people have an equity in property by virtue of birth and citizenship.

This is basic to Anglo-Saxon-Norman land law, taken into every state constitution when it adopted the English common law. It is enshrined in words like "real estate" which, as you lawyers know, is the Norman "royal estate," the king's land; words like "eminent domain," and "fee" (as in feudal). It is enshrined in the priority that taxes enjoy over mortgages and over the fee-holder's equity. Land title chains generally hark back to some European monarch, and all the fee-holder has is what the king gave away; and all the king gave away was tenure subject to taxes. The king never

gave away his right to levy taxes, nor have the kings' successors, the sovereign states. Government is more than a convenience for fee-holders, who are the king's tenants; it is the protector of the rights of the landless.

In 16th century Europe, doctrines of this general stamp were known as the Anabaptist heresy, some of whose votaries were burned at the stake. But it came to the fore in England, and to prevail strongly in the United States and other British settlements, largely via school finance. If that all sounds too radical remember that the property tax is now being attacked for not being radical enough, i.e. not progressive. Attitudes have changed a good deal since they burned Anabaptists. I invite you to entertain the entrancing possibility that a tax which is attacked at once for being too radical and too conservative might, for the great middle American, be about right.

But today the old equilibrium has been disturbed because localities have learned to wiggle out from under their educational servitude by exclusionary policies: large-lot zoning, Cadillac building codes, sewer power, regressive assessment, and over-assessing buildings relative to land. Also, most of them probably underfinance primary and secondary education -- by "underfinance" I mean they dedicate less to education than consumers would choose freely if they were not vulnerable to dilution-through-inmigration.

The solution is not to abolish the property tax, for it is not the problem. The solution is to finance education at a higher

level, state and/or federal. This can be done without sacrificing local or individual control of schools by following the pattern of the G.I. Bill and employing a voucher system, or any other system where state funds are proportional to attendance (A.D.A.) or other formula based on numbers of people. Conceivably such formulae might be modified for differential local costs and "needs", as some school finance people wish, but that is an option. The point here is that support should vary as a function of population, thus giving the distribution the character of a social dividend.

4. Property taxes reduce the differential effect of inherited wealth on the current generation.

5. The property tax is not regressive. I have written an article to this effect, which the staff has, and I will not recite it now. I am delighted that parts of the article were cited in the staff report. I would underscore, however, certain central points that were omitted or overlooked.

a. I have already mentioned here that income, and especially current cash or realized income, is no index to well-being, or ability to pay, either. On top of that, AGI on Form 1040 is no index to income. AGI is what is left over after all the loopholes. Most of the loopholes are related to owning property.

The other day I met two old friends. One had become a millionaire; the other was a taxpayer. So naturally I asked the millionaire how he did it, and he said he listened to Bob Hope, who

related that he had become just a middleman between the paymaster and the Internal Revenue Service until he discovered real estate.

Wendell Willkie once said that a good catchword can obscure analysis for fifty years. The catchword of the generation now pushing fifty has certainly been "income." The staff report, excellent in many ways, comes close to committing idolatry on the word "income." The property tax is judged by comparing it with AGI, or something entirely too much like AGI.

Yet tax economists have long been up in arms against loopholes, and the public is right with them or ahead of them. They tell me it is a most popular campaign issue this year, near the top rating. AGI is neither intellectually respectable nor popularly credible. It is bad enough to stack the cards by judging the property tax on the basis of how closely it resembles an income tax. It is worse to judge it on the basis of how closely it resembles a tax based on AGI. AGI has gotten so bad, I flatly assert any public policy based on AGI is a fraud.

We hear a lot these days about ZPG. I invite your attention to Zero AGI, or ZAGI. Many a millionaire has achieved ZAGI, joining the ranks of ZAGI-men -- rather, in the modern idiom, let us say ZAGI-persons, for indeed many of these persons are women. I met one last month, and I shall never forget her. "My dear," says she, "when the late Mr. X passed on I was simply terrified what to do with all the money, and how to fill out that Form 1040. Then I found this simply marvelous lawyer . . ." I shall always think of

her innocent blue eyes when people speak of the widow with low AGI and heavy burdensome property taxes. She was indignant, and sincerely so, at a system that would let her wealth escape the income tax. But she did want to leave her children provided for.

Now consider how a few ZAGI-persons affect that data which we see on property taxes of "low-income" people related to their property tax payments. My friend Mrs. X would be there, one of the elderly poor. She is a ringer -- most of you know that term, a professional athlete playing as an amateur. She is a counterfeit pauper, a millionaire in masquerade. Suppose she has a million dollars in taxable property and, at 2%, pays $20,000 a year in property taxes. It would take 100 genuine paupers in $10,000 dwelling units to pay $20,000 property taxes. That one ringer in the crowd doubles the mean property tax burden.

Then the statistician takes that mean value and says the average poor person with income below $2,000 pays 10% of his income in property taxes, and it is a groaning burden on the very poor. We had better massage the data some more and get rid of that enormity. Otherwise we may be guilty of following the Marquis de Talleyrand when he said "The masses want to believe in something; for their benefit, nothing is so easy to arrange as the facts."

b. The ownership of property is incomparably more concentrated in a few hands than is the receipt of taxable income. The data are cited in my article mentioned above. In the lower brackets of income, most income comes from labor; in the higher

brackets, from property, and much property income isn't even counted. I see no way to get away from these overpowering facts.

c. Even if the residential property tax were 100% shifted forward, that would not be enough to make it regressive. The staff report, I believe, has overlooked the point that the poor live, by and large, in dwelling units whose capital value is low relative to the rent. Slums have a low price/earnings ratio, and besides that the earnings are a small share of the gross rent because of high operating and collection costs. The property tax is based on capital value, not on rent. Data cited on how rent relates to income are therefore not relevant. Even if all property taxes were shifted to tenants and included in rent, the property taxes levied on the dwellings of the poor are a very small share of the rent.

I believe the report has also missed the point that the rich go in for second homes, summer homes, lakeside cottages, ski chalets, hobby farms, and the like. The rich travel more, and spend more on hotels and motels -- all taxable property. And in passing I must ask, if you seriously push a proposal to provide tax relief just for residential property, have you really thought through just how you might define "residential"? What about the hobby farms that constitute some half the state of Vermont -- or one quarter, or one third, depending on your definition? Let your imaginations loose on that one. If you don't, the tax lawyers will, and I guarantee a generation of the most unproductive litigation

you can fancy.

6. I deplore the use of catchphrases like "relief for the homeowner." There are other life-support systems besides owner-occupied homes, and it is single-minded to judge a policy on the basis of what it does for "the homeowner," or other special class. The world is full of various kinds of fundamentalists. You name it, and I can find ten people who think the taxpayers should subsidize it: hunting and fishing, caribou in Alaska, fine arts, performing arts, highway transportation, the merchant marine, interplanetary exploration, education, religion, medicine, birth,birth control, burial, war, peace . . . it goes on and on. The world has invented the market to help arbitrate these competing claims, or some of them. Anyone who wants to substitute his judgment for the market's needs to face up to a certain burden of proof. For the market, with all its failings, does have a rationale.

Residential relief is not especially called for if it means more payroll taxes, for example. The imputed income from the capital value of the owner-occupied home is already exempt from the income tax, while payrolls are taxed both as payrolls and again as income.

On the other hand, there is a place for residential relief, for example, by deBalkanizing the property tax base and bringing industrial and mineral tax enclaves into school districts with many poor children. We need to tax cars much more heavily relative to homes, for the latter are now providing streets for the cars and

suffering enormous external costs from auto noise and fumes. But "relief for the homeowner" is not an end in itself. Fairness, overall balanced equity, and maximum social efficiency and well-being are more adequate statements of ultimate goals. They do not point to lowering the property tax.

7. I have little or no faith in the Caravan poll. One of the worst ways to find out what people are going to do is to ask them what they think, especially when the questions are not well keyed to the options they have or face. I am more impressed by what people do than what they say. Now there is no tax over which the average voter has so much control as over the local property tax. The rapid rise of this tax testifies to its popularity, not the reverse. It is conventional rhetoric to grumble about property taxes, perhaps because large owners of property set fashions. When I was a graduate student twenty years ago in California, and ever since, it has been the style to condemn the property tax -- and go right on raising it.

If indeed the property tax is so unpopular, it is fair to ask why many states have seen fit to make it harder to raise the property tax than other taxes: to set debt limits and tax limits for localities; to require two-thirds approval on bond issues; to require improvement districts to prove benefits received by property which they tax? There are no such handcuffs on other taxes.

I ask you to ponder the inconsistency, in our current deliberations, of postulating the unpopularity of the property tax while

on the other hand raising the specter that localities, relieved from school finance, will move right in and raise property taxes for other purposes. This is more consistent with a hypothesis that the property tax is unpopular with a minority who would block the majority from making use of it. If it were really so unpopular no one would fret -- it would go away of itself.

D. Property income is divided between the public and the private owner in the same ratio that the property tax rate bears to the interest rate. Thus the property tax burden is not to be judged solely by the tax rate. Interest rates have risen sharply in the last 25 years, probably as much as tax rates. There is some question, therefore, whether the public share of property income has risen at all.

Table 1 suggests in broad national estimates, what may have happened, 1945-1972, to the tax share of property income.

Table 1. Share of property income taken by property tax, 1945-1972, method of crude estimate.

	1945	1972
Interest rate (i)	.04	.09
Tax rate (t)	.01	.02
Tax share of property income, t/(t+i)	$\frac{.01}{.05}$	$\frac{.02}{.11}$

II. We do need assessment reform.

A. The U.S. Census of Governments' quinquennial report on assessment ratios is persuasive and general evidence that we need assessment reform, but it understates how much we need reform. In respect to industrial property, it omits ownerships whose value is judged to surpass a quarter of a million dollars: that is, most industrial property. It is unfortunate that this is pointed out in a part of the Census most users don't get around to reading, even though perhaps they should, so that it took Nader's Raiders to ferret this out -- at least I am in their debt for rubbing my nose in it.

So the staff report is mistaken, I believe, to cite the Census to show that industrial property is not underassessed. The Census is simply not in on the action here, and Nader's data -- that rhymes in Maine and North Carolina, although for different reasons -- Nader's data, non-random though they may be, have more to tell us than the Census.

Much of Nader's data are consistent with and supplement and reaffirm the general principle that land is underassessed. He has focused on industrial landholdings: oil in Texas, coal in the Appalachians, copper in Montana, timber in Georgia and Maine. I know of no reason to doubt the generality of these findings, and many reasons to believe it.

B. The Census study omits the class of land most underassessed, that is unsubdivided acreage inside SMSAs. Much of that

is speculative; much is in estates held by the very (and the very very) rich; and much is industrial.

I studied some of this industrial land in Milwaukee. It was not only underassessed, but regressively assessed. The large tracts were given a wholesale rate, allegedly because large tracts sell for less per unit. At the same time, the city was assembling and/or holding large tracts in an industrial land bank, allegedly because the market put a premium on large tracts. It makes an interesting contrast. I have published some of my findings in "What is Property Tax Reform?", Am. J. of Ecs. and Soc., April, 1972; and in "Adequacy of Land as a Tax Base", Daniel Holland (ed.), THE ASSESSMENT OF LAND VALUE, (Madison: U. of Wis. Press, 1970). I would be glad to make available maps and programs and printouts from which the published data were derived, along with unpublished data.

C. To overcome these problems, we need "unit assessment" of land, whereby land is assessed at the unit standard of the optimally sized parcel for the neighborhood. This avoids the problem of wholesale rates, and incidentally nudges all owners to subdivide, buy and sell so as to optimize the size of parcels.

In some neighborhoods, larger parcels are worth more per unit than smaller ones. The premium is known in the trade as "plottage." In my observation, assessors are prone to overlook positive plottage, but to recognize and discount for negative plottage. This is part of a pattern of regressive assessment, one that the Census

technique of comparing sales with assessments of specific parcels is not designed to detect at all.

The problem of how best to handle plottage is too complex, as well as emotionally charged, to cover briefly. But a few general principles of consistency and symmetry should govern:

-- if we assess the subdivision increment, we should also assess the assembly increment, and vice versa.

-- if we assess the assembly increment for one class of building, e.g. apartments, we should do the same for others.

-- if we assess buildings, we should also assess plottage increments, lest we bias investors from building on land to trafficking in land to excess.

-- it is better to assess the potentiality of plottage increment than the achievement of it, lest we penalize optimal subdivision and assembly, and subsidize holdouts and holdups.

-- the effort to achieve assembly plottage ties up land, but one gains the subdivision increment by releasing land and lubricating the market. When in doubt, therefore, the breaks should go to subdivision, as being more consistent with social and political democracy, and the rule against monopolies. If we must choose, progressive assessment is better than regressive.

-- the existence of large plottage increments often indicates the dereliction of local government land planning and public works, and should be taken as a clue to improve public performance.

D. We need develop a tradition and an expectation of annual reassessment. In an economy where we take for granted annual inflation of 3%-5% in the CPI, it is absurd that raising assessments should be the cause of special traumas. In the absence of specific reassessment, it would be much more reasonable to assume an annual increment in value of 4% or so, just to keep up with the annual debasement of the currency. In most suburban areas where land values are rising disproportionately, i.e. faster than the CPI, it would be reasonable to add another factor for that.

Otherwise we build in an automatic bias due to the lag in assessments. New buildings are generally assessed at or near cost, reflecting the latest inflationary rises. Land and older buildings are assessed at the values of ten or twenty years past.

Lest one good custom should corrupt the world, the automatic inflationary assumption should not be a rote exercise, but based on fact. Otherwise we would create new biases. However, we are at present so lopsided in the other direction that I do not regard that as a primary threat now.

E. The value of assessment reform is much greater than the gain of revenue, however great or small that may be. Increased taxpayer confidence and acceptance are equally important. I do not think that people who countenance corruption and maladministration have any inkling of how destructive these are to the morale of citizens who are outraged first by the facts, and then outraged

again by the complaisance and laxity of responsible officials who have the power and duty to act.

Again, as Kenneth Back points out, the revenue productivity of a tax is limited by the suffering of those most impacted, i.e. those overassessed and paying the highest effective rates. These become the widows and orphans trotted out to damn the entire system.

F. We can move halfway from here to the site value tax without changing any law, simply by obeying the laws we already have and assessing land at market the way we do buildings. I do not exaggerate. Listen to what people say when an assessor moves toward bringing land up to market. "The assessor has gone hogwild." "He's trying to tell people how to use their land." "The assessor is taking over the planning function." "This vicious radical theory of market value." "Our community is unique." Sound familiar? It gives a notion how time has withered and custom staled the notion that all property should be assessed on the same basis according to law.

I invite your close attention to what has happened in a few jurisdictions whose assessors have brought land up to market. Rosslyn, Va., just across the Key Bridge from here, is one you can see out the window. Southfield, Michigan, is another. Sacramento, California, is a third.

I further invite your attention to the cities of Canada, especially western Canada, where assessors traditionally light heavier on land than they do here. These cities compare favorably in most

respects with the remains of many of ours.

The underassessment of land is worse than the Census shows, at least in my experience. The staff report cites Allen Manvel to the effect that 40% of urban real estate value is land value, and I believe the true figure is at least that high. But in most city assessment rolls it is down nearer 20% or 25%.

To correct this underassessment, assessors need to move toward the following package of practices, in my opinion. First, always assess land separately, rather than assigning it an arbitrary percentage as is done in some jurisdictions. Second, assess land first and assign the building the remainder of the value, thus allowing for the enormous factor of locational obsolescence. This is known in the trade as the "building-residual" method. It reduces the value of many buildings to zero and would work a revolution in assessment practise and the division of value between land and building. Third, revalue land annually. In the absence of specific individual appraisal, impute each site the advance that characterizes its neighborhood. If that sounds broad-brushed, remember that all tax assessment is mass appraisal. Fourth, assess land using a unit standard, with allowance of course for corner and shape and access and other conventional factors based on experience. (The square foot is a better unit than the front foot because the front foot basis contains no incentive to avoid excessive depth of lots.)

Going to the unit basis entails using maps to show the spatial relationships of land values, an art developed in the 1920s but almost lost in the United States today, although alive and well in Australia, Canada, East Africa, Denmark, and elsewhere. Maps of this kind are cheap to print and distribute, and are a natural vehicle for citizen audit of tax administration. I deplore the secrecy and inside dealing that characterize the administration of many taxes. How many times have you heard Form 1040 described as the "first offer"? Taxes are public business, and a map lays the business bare as anything could.

In rural areas, soil maps are everywhere available. These, in conjunction with road maps and market information, are the basis for accurate assessment.

In sylvan areas, every forest owner likes to overstate the value of stumpage for federal tax purposes (to transfer profit to timber culture, which gets capital gains) and to understate it for state and local excise and property tax purposes. All that is needed here is for state and federal tax officers to exchange information and demand the same valuations be used, although of course immature timber must be discounted from its maturity value.

The most underassessed of all properties are mineral reserves. Producing properties are underassessed; reserve properties are not assessed as mineral-bearing land at all. This has something to do with the problem of measuring reserves, but not very much. It has more to do with differential political power, and constitutes in my opinion, one of the worst breakdowns of the democratic process that we suffer.

In West Virginia, for example, U.S.G.S. maps of coal reserves have been available for a long time, but not used. Recently the State Department of Assessment has begun staff work to help local assessors use these maps, and to win the court cases that inevitably follow, but it has too often been the old story of young innocents up against old pros, and a low batting average.

I recommend, Mr. Chairman, that the U.S.G.S., Bureau of Mines, or other federal agency be instructed by Congress to cooperate actively with state and perhaps local agencies in the process of valuing mineral reserves. This entails not just ascertaining the physical volume and grade, it entails valuation, an economic art.

If it be anticipated that states might not cooperate, I suggest that no state be allowed to plead poverty in Washington until it has done so; and I predict that few of them would have any reason to plead poverty afterwards.

If it be anticipated that the agencies might not cooperate, or would represent the assessed instead of the public, then a new agency may be called for. Whether in a new or old agency, new personnel are needed, with new skills and a sense of the new mission.

G. The underassessment of land by local assessors is used as conclusive evidence in disputes over income taxes. Land is not depreciable for income tax; buildings are. Understating the share of land lets the taxpayer overstate the depreciable share of real estate that yields cash flow. It lets the owner of income property depreciate land.

There is little useful incentive effect of this tax break. On the contrary, it is one of the main reasons for the nonrenewal and decay of our cities. Not even ecologists will smile on the wildlife it shelters, the Rattus norvegicus, Rattus rattus, and friends. The main shelter goes to owners of older buildings. As you know, every time an old building is sold the new owner may depreciate it again, from the new basis established by his purchase price, never mind how many times the building has been depreciated before. It is bad enough to let an owner depreciate land once only. If you figure it out, it is tantamount to exemption in perpetuity, for all the Treasury gets thereafter is a return on its own investment in uncollected taxes. But our tax system lets land be depreciated many times running. The income is not only exempt, it is supplemented by the Treasury, for each additional false depreciation is a gift.

This practice constitutes an arterial hemorrhage from the Treasury. It affects most income property, non-residential and residential both, and thus affects more than half of all the property there is. I have not tried to estimate how many billions of tax money bleeds through this rupture, but it can hardly be inconsiderable. It is quite conceivable that it might match the collections of a VAT.

Mr. Chairman, I recommend that there be established, presumably in the Internal Revenue Service, something like a Federal Board of Equalization, whose function would be to prevent local assessors from helping their constituents lower their income tax liability in

this manner. Otherwise we never will get true assessment of land, for you need little imagination to see what pressure this inevitably brings on the local assessor, a pressure that is all one-sided. What we have now is a modern variation of the old problem of competitive underassessment. States solved that problem at low cost by the use of boards of equalization. The Federal government can and should do the same.

H. We keep hearing of public land purchases at prices far above equalized assessed value.

III. We do need to shift the property tax to the state level.

Half the reasons one hears cited for damning the property tax are not arguments against the property tax as such, but against tax enclaves, against Balkanization, against fiscal zoning and havens of high per capita tax base. These are arguments in favor of shifting school financing to the state level. The property tax is only incidental, and included only by confusion.

Serrano v. Priest and like decisions in other states after California have not outlawed the property tax for school finance. Rather, they have outlawed gross inequalities in the local tax base used for school finance. One way or another, the courts are saying, tax bases must be equalized at the state level.

It is not necessary at all, therefore, to relinquish the property tax, but only to move it to the state level. Thus all the local tax havens will automatically be tapped for the benefit of every school

child -- and without the need for families to move to invade the tax havens, either, and I submit that when people start locating without being influenced by this factor, we will achieve a much more compact and rational pattern of metropolitan settlement.

It is not just industrial tax enclaves like Emeryville, California, West Milwaukee, Wisconsin, and Clearing, Illinois that will be tapped. Butte, Montana, Hibbing, Minnesota, and Kern County, California look like good candidates, too, with their mineral wealth. (Mineral wealth is concentrated in a few places, usually remote from populous school districts.) So do the under-taxed forest lands of Maine, Oregon, and Florida, and the coal measures of Appalachia.

The staff report suggests that the quality of property tax administration would improve, too, at the state level, and it is my impression that assessment is a function whose optimal scale is larger than most assessment jurisdictions presently going. The ideal arrangement involves a compromise between the advantages of scale and those of local intimacy, with staff work and research and training conducted at the state level, and nuts-and-bolts assessment at the county level, with equalization and review again at the state level.

However, the staff report emphasizes this lesser gain while not treating a much greater and really basic gain from state assumption of the property tax for schools. The quantum advance in the quality of American government that would result is the change of local

incentives toward inmigration. Now, every tax jurisdiction in the country, be it suburb or central city, is fighting to dump its fiscal deficit generators over its borders. So every one adopts exclusionary low density zoning, and a host of allied policies designed to repel the poor and avoiding diluting the local tax base. But given state support of schools, local governments would be faced with a different set of incentives and become much more hospitable to the poor. We had better move in that direction soon, or we will create a class of people who have no place to pitch their tents but in the public expressways. Anyone who thinks that is a good idea had better review the data on rising rates of crime and welfare dependency. For a democratic society to work, we need local governments that compete to attract people, not to exclude them.

IV. We do need to convert the property tax to a site value tax. Dick Netzer and Lowell Harriss and I and others have written a good deal on the advantages of this approach, and I will merely summarize here some major advantages, without constructing an organic argument.

A. The proposal is to exempt capital from the property tax base, and focus it on land value.

B. There would be little or no loss of tax base. Untaxing buildings adds to site value an amount as much as the capitalized value of the building taxes, and this new value becomes part of the

site value base.

Thus, we would be taxing the same real estate; we would just be taxing it in a different way. In its citation to me, the staff report overlooks this, my major point.

C. For the same reason, there would be, in general, no invasion of the present owners' equity in land. There would be some reshuffling, and over a transition period there would be a recentralization of values because the redevelopment of inner lands would satisfy and pull in the demand now proliferating over peripheral areas. Judging by what one hears, most owners in peripheral areas would prefer it that way.

D. The market would become the judge of what is the best use of land, unswayed by tax bias, as now. When buildings are taxed, the tax biases the owner in favor of the use more lightly taxed.

Nowadays, one often hears people decry "highest and best use" as though it were some kind of morbidity. There may be a tendency for social critics to overstate the external effects of a land use and understate the basic internal purpose. Highest and best use simply means that use offering society the greatest net service flow, insofar as the market is able to judge it. Those not accepting the market's judgment need to show that their objection is based on something more substantial than, for example, a subjective esthetic reaction. It would only be a form of tyranny to let taste dictators judge the external effects of a building on the sort of

emotive basis that is fashionable among architectural journalists.

A more objective method, I believe, would be to note the effect on land values across the street. In my studies of land values, I have almost always found that highrise buildings, even something like the Allen-Bradley building in Milwaukee, a six-story factory that uses its land to the sidewalk, raise values around them. I cannot say the same for gas stations, junk yards, auto dealerships, and vacant lots -- no, not even cemeteries -- and I wish that those who are concerned with external effects of land uses would get more exercised about those that can be objectively demonstrated to harm their neighbors.

E. Taxing buildings slows down renewal and replacement of decayed and obsolete buildings by new. Taxing land does just the opposite. It drains cash from the holdout and the sleeping owner of undeveloped land and presses him to improve, or sell.

We hear a lot about how the site value tax is economically "neutral," and lets the market alone to do its work, and in an important sense that is true. But tax theorists have long noted that taxes have two kinds of effects. There is the marginal effect; and the wealth effect. Land taxes have no marginal effect, that is, the marginal increment of capital applied to land is not taxed, and that is a great virtue. But land taxes do have a wealth effect. They drain wealth from holdouts and reduce their holdout power. It is not a small matter.

In some European colonies in Africa, the European governments once forced natives to work in the mines by levying a head tax. The natives, living happily in the bush, had to work in the mines to raise the money to pay the head tax -- or else go to jail. That is a wealth effect.

The land tax uses the same principle in favor of labor. It forces landowners to put land to use to pay the tax. But there is no jail in view. It is a carrot and stick thing. The carrot is the option of building on land free of building taxes. The carrot and stick together get guaranteed results. The carrot balances the stick in terms of equity. And everyone gains.

F. Taxing land economizes on public capital. When public works are extended, land assessments rise, bringing in private buildings to match the public, nicely synchronized with it and with each other. Planning needs such a tool.

G. Compact settlement reduces almost all public costs per capita, since most of these, and many private costs as well, vary with the length of streets and lines per capita. This important principle has been obscured in many studies because they have compared old, obsolete cities at high density with new settlements at low density; and because they have lumped people costs with land-service costs. High density does not reduce school costs, except in small ways. It does reduce street improvement costs, capital budgets, distribution costs, and all costs that vary with area, -- like flood control and radio coverage, for example.

H. The share of wealth that is land tends to increase with total wealth, making the land tax very progressive.

I. The land tax may be as heavy as the community likes without driving away capital, but only attracting it the more. No other tax can make that statement.

J. By stimulating rebuilding and new building and putting land to full use, the site value tax stimulates employment. This in turn cuts down on welfare costs, affording true tax relief.

This has to be viewed in the national perspective. Many of us are hung up on viewing the property tax in provincial and particularistic terms, and think of employment as a pestilence, inviting problems into our enclave. But here we are discussing the property tax as a national institution. The national effects of a national change in the character of the tax would be to increase the demand for labor nationwide, and abate the problem of unemployment and its derivative evils. It would not involve flooding any one particular jurisdiction with the rejects of all the others.

Looking at it this way, you can see why some have thought that the site value tax might tend to accomplish the goal that we once hoped Keynesian policies might achieve, to wit full employment. Society has now allowed this Utopian dream to be entertained, and even legislated it as a national goal in The Full Employment Act of 1946. The Keynesian approaches seem to have been pushed past their load limit, but perhaps at least it is permissible to dream

some more. It was unrealistic of the old Georgists to expect local jurisdictions to solve the national unemployment problem with local tools. But now that we have a national Full Employment Act, and an Advisory Commission on Intergovernmental Relations that is concerned with the property tax, could we not begin to think of the property tax in part as a tool to help achieve full employment?

V. Summary

I have eight specific recommendations.

A. That the Bureau of Mines, the U.S.G.S., and/or other appropriate federal agencies, be instructed and funded to work actively with state and/or local assessors to help assess mineral reserves.

B. That the Internal Revenue Service be instructed to share information with local assessors in order to help improve the assessment product.

C. That Federal acquisition of real estate at prices above its equalized assessed valuation be declared contrary to public policy. Either condemnation shall be at the equalized assessed value; or else the entire jurisdictional assessment shall be challengable by any other affected party.

D. That timber valuations for income tax be made identical with assessed valuations for state and local taxation; and the same for mineral valuations at the time of severance. In each

wished to.

The second change is revenue sharing. A Federal property tax could be apportioned by population, and the revenue then be shared in the same way. The Constitution tells us how taxes must be apportioned, but with spending, anything goes. So, as Professor Don Hagman of the U.C.L.A. law school has pointed out, apportionment is really no constitutional barrier to an effective use of the property tax by the Federal government. Think about it.

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