



Bench-Mark Taxation Interview with Dr. Mason Gaffney

By Dr. Mason Gaffney

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TO MASON GAFFNEY
FROM DAVID MARTIN

HAVING RECEIVED DEC 31, 1989, I'M GETTING
AROUND TO CLEANING OUT SOME BOXES
OF FILES. "HISTORY IS BUT A BUCKET
OF ASHES" - ROBERT FORT.

SUBJECT: Bench-Mark Taxation

June 1972

Interview with Dr. Mason Gaffney of Resources for the
Future, Washington, D. C.

(Interview conducted by James
Johnson from the Senate
Subcommittee on Antitrust and
Monopoly)

JIM JOHNSON: Dr. Gaffney, as a result of the insurance hearings, the Subcommittee is interested in the subject of bench-mark taxation. One of the witnesses (Metropolitan Life Insurance Company) expressed great difficulty in assembling large tracts of land which results in high costs and which ultimately are passed on to the consumer. The witness recommended that much could be done to lower costs by taking a serious look at real estate tax methods and at the land speculator who sits on idle property. Senator Hart responded to Metropolitan Life by asking if MLIC were suggesting a bench-mark tax to alleviate the problem of assembling large tracts of land for development.

Dr. Gaffney, would you comment on bench-mark taxation?

DR. GAFFNEY: Dr. Martin [Dr. David D. Martin, Chief Economist for the Senate Subcommittee on Antitrust and Monopoly] mentioned to me on the telephone that after Senator Hart questioned what could be done in the area of bench-mark taxation, Nat Roggie (of MLIC) spoke up and suggested that federal grants of certain kinds should be contingent on reform of local governments' administration of local property tax.

Along the lines suggested, that certainly is one possibility. It would also involve substantial presumption on the part of Federal Government to interfere with local autonomy, which might

raise objections which could be an obstacle. It occurred to me that another approach which is more directly Federal has to do with income taxation.

What you have is a species of behavior on the part of local assessors which is quite comparable to what used to be called competitive under-assessment. The competitive under-assessment arose when states were collecting property taxes or counties were collecting, and the property was assessed by the local assessor or a number of local assessors. Each local assessor was motivated, in order to continue doing the tax payment from his jurisdiction to the county or state jurisdiction, to under-assess relative to other assessments. This quickly lead to set values down to the neighborhood of 1% of true market value or would have if allowed to run to its logical conclusion. To combat this the states and counties set up boards of equalization. The function of the board of equalization was to make sure that the localities were assessing the property comparably; they were operating simply by checking sales after the assessment value (or lets state that another way) the ratio of assessed value to the sales value which was almost always less than one. In comparing these different jurisdictions and then correcting the local assessments accordingly so that for example assessments to sales

ratio in a certain jurisdiction was 25% or 1 to 4, then the assessments recorded on all property would be quadruple to bring them up to 100% for parity with other assessments.

Now what we are faced with today is an analogous situation on the part of the Federal Government. Here competitive under-assessment takes a different form since the Federal Government does not collect a property tax.

JIM JOHNSON: When you use the phrase competitive under-assessment, what do you mean? Who is competing?

DR. GAFFNEY: Different local jurisdictions are competing with each other to under-assess the value of the land. And originally to under-assess the value of all property -- that's how the term "competitive under-assessment" originated. The relationship between land and buildings becomes crucial when we are talking about the administration of the Federal income tax.

Here what is going on can be termed competitive under-assessment in the same sense; but when you are talking about income tax as applied to real estate, a lower tax burden for Federal income tax purposes may be achieved on income property by understating the value of the land. This comes about because under the income

tax law, income property can be depreciated several times; after the original building is depreciated once, the owner sells. (Well, let's look at what the second owner does.)

The second owner can then depreciate all over again starting from his purchase price -- which is known as his basis. At this point it becomes important, however, to allocate this basis between land costs, which are non-depreciable, and the building costs, which are depreciable. It is in the interest of the taxpayer seeking to become a non-taxpayer to turn this into a tax shelter.

It is to his interest to allocate as much as possible to the building which is depreciable and, therefore, as little as possible to the land which is non-depreciable. Now then, the question arises -- how is this allocation to be made or if it is challenged by the Internal Revenue Service, what objective reference is to be used to determine the correct allocation? Now, the practice almost universally is to accept the statement of the local assessor as to how value is allocated between land and building. As a result, every local assessor in the country is under pressure from owners of income property, who generally are the more influential people

in the jurisdiction, to under-assess land. Now, to take a specific case -- Ken Back, who is the Director of Finance in the District of Columbia, is on record to the effect that when the District of Columbia reassessed land about five years ago there were almost no objections on the part of property owners with respect to increases in their total tax bills; but, there is strong objections on the basis of the allocation of more value to the non-depreciable land which forced the owners to pay more value to the non-depreciable land which forced the owners to pay more Federal income taxes. The District of Columbia happens to be one of the few jurisdictions in the country which does assess land properly. Most other jurisdictions are under-assessing land by a very large factor.

JIM JOHNSON: Dr. Gaffney, would you elaborate on the argument against higher land assessments given in your April 1972 article entitled, "What is Property Tax Reform?" printed from The American Journal of Economics and Sociology, particularly the argument that higher land assessments will place an undue burden on the poor?

DR. GAFFNEY: I didn't give that argument in my article.

JIM JOHNSON: That is an argument, however, that is mentioned.

DR. GAFFNEY: Oh, that's given.

JIM JOHNSON: Can the poor really afford higher land assessments when they live in and own rundown housing?

DR. GAFFNEY: We are not concerned here with the total level of property taxes but just with the allocation between land and buildings. We have some poor people who suffer from the fact that buildings are over-assessed and contrary-wise if you changed it and assess property at its market value -- both land and buildings -- I am sure you could find some people who were poor who would suffer. However, this would be more the exception than the rule. I have collected some data on this subject and others have also indicated that the ownership of land tends to be much more concentrated in the hands of the wealthy than is the ownership of buildings. Or, putting it another way, poor people live in neighborhoods where the value of land is low; and even though they live in buildings whose value is low, the ratio of the building value to land value is generally higher in the neighborhoods where poorer people live. An extreme example of this is flood plane land or derelict land of some kind that no one wants. There you might find a neighborhood occupied by the very poor on land of practically zero value. The only time you do find very poor people living on valuable land is in a transitional area -- the building is to be

demolished in the near future. But, by and large it is the other way around. I have data on that which I have put together. This data has several cities on this subject. Footnote No. 29 in this paper ("The Property Tax is Progressive Tax") cites several sources of data from empirical studies indicating that the share of real estate value, which is land value, rises as the value of property increases. Putting it another way, poor people live on very cheap land; and they also live at very high density. Putting these two factors together you find that land belonging to the poor has very low land value.

Of course, this raises a different question from the one we started with which was, what is the feasibility of bench-mark assessment that the Senator referred to?

I think it is a very important question; and another very relevant question is would it make property tax more progressive or less progressive? And, I think the answer is that bench-mark taxation would make property tax more progressive by putting more emphasis on land.

JIM JOHNSON: So you feel that the wealthy will pay a larger share of what is now commonly called income tax.

DR. GAFFNEY: We have two taxes in question here -- property and income tax. The effect of putting more emphasis on land would

make the property tax formidable for people who own more real estate. At the same time, it would also change the income tax and would make people who own income yielding real estate pay more income tax by cutting down their depreciation deduction.

JIM JOHNSON: So it would be double edged.....

DR. GAFFNEY: Yes, a double edged....no, not a double edged but a double barreled shotgun.... It would hit them twice -- once in the property tax and once in the income tax.

JIM JOHNSON: Should the Senator ever have to defend the proposition of a bench-mark tax he will have to show the necessity of such a program?

DR. GAFFNEY: Yes.

JIM JOHNSON: I noticed in giving your paper entitled, "What is Property Reform?", a quick perusal, that you gave a list of reform priorities. Do you see these as being consistent or germane to what we are discussing now? Would you give some interplay between the priorities you listed in your paper and the reasons the Senator may or could give for instituting a

reform such as the bench-mark tax that would change our present tax structure by closing the gap of such a large tax loophole.

DR. GAFFNEY: I will try to put myself in the Senator's shoes.... He, the Senator, is concerned with antitrust policy first, not tax policy as such; but he would be interested in how this would effect the competitive system -- whether it would make the system more competitive or less.

Now, here I think putting more emphasis on land would be very consistent with making the system more competitive. That would be one of the strongest arguments in his favor; and contrary-wise, those who are against it almost always use arguments which are thinly veiled statements of a monopoly imposition.

To be a little more graphic about it, the effect of taxing land and reducing the tax burden on buildings is to increase the supply of buildings; and those who oppose this policy almost always say the new buildings will pull tenants away from old buildings. Now another way of saying that is it will increase the competitiveness of the market and will make the real estate market more competitive. And this is true in the housing market, this is true in the office market, and it is also true in the retail market. You get an awful lot of deliberate suppression of competition in the retailing

field which operates through zoning, but also operates through property tax. And, people who are afraid of taking the brakes off in the construction of new buildings are frequently afraid of competition specifically. This could be documented at considerable length if one wanted to. So, I am very sure that putting more emphasis on land assessments and lowering building assessments -- especially the assessment of new buildings -- would make the urban economy more competitive and certainly more compatible in some areas.

Now, when you get into big industry, corporations with national markets as opposed to retailing, office, and residential space in local markets, then you get into a closely related question; and Dave Martin has done some very good work on this himself. In a chapter he published in a book that I edited on extracted resources entitled, "Extractive Resources and Taxation," in which we studied the ratio of mineral reserves to output. This was with corporations according to their size. We found that the larger mineral corporations tended to hold larger reserves of land relative to output than smaller corporations so that, for instance, (let me pull some figures out of the air) they are not too far wrong. U.S. Steel had a 100-year reserve of iron ore at the rate they were going. Whereas, smaller steel companies had a 10-year reserve indicating that the larger companies had much more land relative to its output than the smaller companies. This pattern that Dr. Martin discovered

is very much in line with my observations of a systematic pattern.

JIM JOHNSON: I would like for you to elaborate on studies that would show the results and problems of a bench-mark taxation program in other countries or in specific areas within this country.

DR. GAFFNEY: I am sure Mr. Henry Schecter can explain areas in this country that have successfully used a system which approaches bench-mark taxation. (Dr. David Martin knows Mr. Schecter.)

Mr. Schecter, along with his research assistant Mr. Terry, put out this pamphlet entitled, "Property Taxation Effects on Land-Usage," dated February 24, 1971. It was submitted to Senator Muskie's Subcommittee on Intergovernmental Relations. It has a considerable section on what they call land-value taxation which is related to the concept of bench-mark assessment, as you have expressed it. It starts on page 36 of this pamphlet. It discusses American experience and foreign experience with land-value taxation. I would regard it as simply introductory -- especially the part on foreign experience. (Mr. Schecter is with the Congressional Research Service.)

There is a book on the subject that was put out by Australian National University. It is called "Urban Redevelopment in Australia." I don't have a copy of that; but it is cited in this book, ("Assessment of Land Value"). This book was published by Wisconsin University Press.

This book also sketches the American experience. It also surveys the literature on the subject. (Ample footnoted.) I think this would be a good start for research on the subject.

This book on the Assessment of Land Value gets into the nuts and bolts aspect of this bench-mark assessment in some length.

JIM JOHNSON: Is the term bench-mark actually used?

DR. GAFFNEY: No it is not used in here as far as I am aware. It is a perfectly good term.... I might say a word or two about that. Actually, bench-mark as was described in the hearing is a little bit misleading because the man from the insurance company who was describing it made it sound very unusual.

Actually, all it means is assessing land according to the market, which is what the law directs. The fact is that the law which directs this is generally not followed. Most assessors break the law every time they assess land. But the law says

that all property shall be assessed at market value, and the rules shall be uniformity.

JIM JOHNSON: Metropolitan Life Insurance Company statement.(501)

DR. GAFFNEY: Well, the freeze here that I take exception to is where he says to tax the land on the basis of what society judges its use should be, not on the basis of the appraisal of the building. Well, where he says what society judges, that sounds a little bit arbitrary, especially if some government official walked in and said we think this land should be used for something different than it is being used for. Actually, what happens is that the market makes this judgment---some buyer walks in and says I'll pay more^{for}/this land than its worth to you in its present use and that is what determines the market. The assessors merely follow the market or should. If the assessor merely follows the market, he would automatically raise the assessment of the land when potential bidders want it for that use. We wouldn't go in there and arbitrarily set the value. We wouldn't arbitrarily say that it should be put to another use.

JOHNSON: The assessment wouldn't really be changed until after the sale of the assessment.

DR. GAFFNEY: Well, that's not quite correct. Suppose you have a block with 20 parcels of property in it. They are all in single family houses and somebody comes in; and it's more for one parcel of land because you're going to build an apartment there. That would mean that all that land had that potential use in that block. This would not be based on an arbitrary judgment; it would be based on that they were buyers wanting to pay that price.

JIM JOHNSON: Then, if you have a house within a block where land assessment has increased and if you are of modest means, then in effect you are being forced out, are you not?

DR. GAFFNEY: That's right. If you look at the big picture, the policy of assessing land by its market value, aside from the fact that it is legal, and any other approach is illegal, is designed to minimize this problem by concentrating this transition in a smaller area. What happens now is it is very difficult for the apartment building to assemble a site. Starting with the premise that opened our discussion, an apartment builder would take an option and would buy a lot somewhere. Let's say he would need to assemble three or four lots to build an apartment. He would buy a lot and take an option on the one next door, and he will try to assemble a site. Say he makes it on 10th street, and he gets one apartment going on 10th street. He then tries it again

on 11th Street, but he doesn't make it there. He doesn't make it on 12th Street, and it's not until he gets out to 13th Street that he scores again. Then he gets an apartment on 10th Street and another on 13th Street, and in between you have single family houses. You repeat this pattern all over the city; and you get the transition from single family to apartment use, spread over several square miles instead of concentrating on a few blocks. This creates a kind of floating value that effects an enormous area and disrupts the market in that area instead of doing it all and getting a tooth pulled all at one time over a period of six months. The idea of the site value tax or any approach in that direction, such as bench-mark assessment, would be to concentrate the transition in a smaller area. Now, nobody could deny that it is going to move out the old owners, or at least cause them to change the use of the land; that's the purpose.

JOHNSON: How would it benefit the homeowners?

DR. GAFFNEY: Well, it would make them rich probably. They will be getting rich anyway. As the land becomes eligible for a higher use, they will be able to sell out for a higher price. One of the great ironies of our time is that owners of land in transitional areas are weeping bitter tears of the rising tax assessments. Their land rises in value of \$50 for every \$1 the tax bill goes up. But they scream about their taxes and act as if they are being confiscated

when in fact they are being enriched. The tax mechanism is only taking a little bit of it back.

JIM JOHNSON: To sidestep just a bit here, how do you view the Washington Area Metropolitan Council of Governments? They are supposedly planning and coordinating the growth of the area. Do you see the planning council playing a more effective part if a site tax is initiated in the Metropolitan Area? Do you see them having more control? (One of the hot topics in urban economics is that cities just spring up -- the seeds of development and growth are just scattered. No coordinated planning is involved.

You mention the floating which is present as a result of the developer having to jump around over a ten block area. The disruption results when in rather than having just one neighborhood in transition you have an entire section of a city in disruption and transition.

DR. GAFFNEY: Well, this question has been raised; and in general, I think the answer is that the site value tax gives planners a positive level of power. Whereas their present arsenal of power is primarily negative. We have the power to say no through

the control of zoning. But you don't have any sort of mandatory injunction that says you will improve the piece of land for a certain use. Now, the site value tax does not contain that either. It doesn't give the planner power to say that the piece of land will be used for a high-rised apartment or grocery store or gas station. What it does, however, do is that when the planners say we will put the sewers in this area the value of the land rises, and then the assessment rises. This builds a fire under the owner and forces him to improve in the manner that he deems best, but taking into consideration the fact that the sewer in the street and whatever public works the planners have put in there is now available. So, in this sense it gives the planners a lever of power to possess; and it makes it possible for public works to lead rather than lag. In other words, you put the public works in and then you know the private owner is going to respond. So, I think it is very important that planning and property taxation be integrated, especially if you move in that direction of site value taxation or bench-mark assessment. To rap up the things we have just been talking about, let me give you a copy of this article called "Land Planning and the Property Tax" from the AIP Journal in May 1969.

BREAK-----

DR. GAFFNEY: Getting back to this question of bench-mark assessment, which I guess is your main interest, I would like to recommend the book that Daniel Holland edited called "The Assessment of Land Value," published by University of Wisconsin Press in 1970. Specifically, there are four or five chapters in here that bear on the subject: one by Ken Bach, who is the head of the District of Columbia Finance Department, and would be available to discuss this I'm sure, called "Land Value Taxation in Light of Current Assessment Theory and Practices;" and a second one by John Coats called "Reckoning with Imperfections in the Land Market." John Coats is an Australian who worked for the United Nations in Jamaica specifically on their land evaluation problems. Then, the "Preparation In Use Of Land Value Maps" by Don Beach gets very much to the point. Mapping, I might say, is of the essence if you are going to assess land in this way; and it is important to insist that a unit value be put in every piece of land, which depends on the location of that site regardless of what's on the site. In order to do this,^a good mapping program is essential. Well, those chapters in this book (Assessment of Land Value, by D. Holland) would be particularly relevant. Now, along the same lines there is a chapter on mapping by an Englishman, Byron Amsky, which is chapter 2 in this book called "Land Values", edited by Peter Hall, published in England by Sweet and Maxwell, 1965. Amsky has in here some sample maps..... Byron Amsky has dr wn a number of maps of land values and

indicated his methods. While it is a short and fairly crude article, you see these maps he has dr wn showing how he wo uld put on a unit evaluation and a text showing where his data comes from and things like that. This is the kind of thing you get into if you start assessing land on this basis.

JIM JOHNSON: It looks like some of Jan Jacobs' maps.

DR. GAFFNEY: Oh, I didn't know she had that systematic a brain..... Then, finally along the same lines J. F. Murray, an Australian, has written a book called Principal and Practice of Evaluation, which is generally considered the classic in this field. This was published in Australia by the Commonwealth Institute of Evaluators, in the 4th edition, 1969.

JOHNSON: Does Australia use a site tax system of taxation?

DR. GAFFNEY: Several cities there do. Australia is probably the leader in the field, although many of the cities of East Africa do also. Nairobi for instance is one which is on a complete site value system. That is decribed in a general way in John Hugh's book on taxation in tropical Africa. But, he doesn't

get into the assessment question and Murray does. By and large, the Australians seem to have written the books in the field.

JOHNSON: One question in line with this -- not to be side-tracked -- what effect of redistribution of wealth a site value of bench-mark tax would have in our society?

GARTNEY -- Well, I think we pretty well covered that before when we talked about the vicinity aspect of it.

Or did you have some other aspect in mind?

JOHNSON -- If one is interested in a major campaign to redistribute wealth in this society, would this be a viable tool or one of the tools he could use in our present institutional structure using the laws we already have?

GARTNEY -- Oh yes, very much. That's a point I lean very hard on in my article (What Is Property Tax Reform). The property tax, well any tax, is a way of redistributing wealth, but the property tax and income tax more specifically are redistributive in that they bite the rich much harder than the poor man. Now, in respect to the property tax there is some debate on that subject. A lot of people have said that the property tax is regressive.

I believe this is a seriously mistaken notion, and that is why I wrote the piece called "Property Tax Is A Progressive Tax;" however, that is just my opinion and it certainly should be regarded as a moot point. But assuming that I am correct, then the property tax would be a means of redistributing wealth, without actually confiscating title to the property. If you must make the owner pay a heavy tax you will get the same effect. But more directly related to this question -- you ask if benchmark taxation would be useful for redistributing wealth, the answer is very much -- yes. Because if the property tax

is regressive in its present form -- this is based entirely on the assumption that the tax is shifted to the consumer or the tenant, now the only rationale under which the property tax could be shifted to a tenant applies to the part of the tax which falls on the building, the part of the tax which falls on the land is not shifted to the tenant. Nobody thinks that as fair as I know, its borne by the land owner he has no way of shifting it.

As a matter of fact, shifting of a tax comes about if the tax reduces the supply of the thing that is taxed. The price goes up and the consumer pays.

The idea about taxing land values is that the supply is not reduced by imposing tax and, therefore, it stays on the land owner. But actually when you look at the tax you can make a stronger statement than that. The effective supply is increased because if you levy a tax on land which is paid annually without respect to the use the land is put to, it causes land to be thrown on the market that is now being held off the market. It causes land to be used more intensively that is now being used very loosely in many large estates or industrial land that is held for alleged future expansion. The way Howard Hughes, for instance, holds 1200 acres in Culver City, California for a plant that occupies two hundred at most or the way he holds half of the strip in Los Vegas or the way he holds many thousands of acres elsewhere around the country which were detailed in that recent "Forbes" article by Noah Detrich, which Dave Martin referred me to. Or when you look at holdings of mineral land it becomes even more strickingly true if

you put a heavy property tax on mineral land this couldn't possibly be shifted forward to the consumer. If it does have an effect, it will tend to accelerate the production of the mineral and cause the price to fall and supply to rise. Well, all this tends to redistribute wealth from the hands of people who now own property to consumers. Just as sales tax is regressive anything which acts the other way and lowers the price to consumers has a progressive quality about it.

JOHNSON -- Earlier you mentioned the Federal Government going out and assessing land and you commented on a dual system.

Would you elaborate on that as to how that would work.

... Also, how do you think the Sierra Club would react to government encroachment in the area of land value assessment.

GAFFNEY -- Well, let me take that one step at a time:

1. The proposal that I made is not that the Federal Government should assess property directly, but it should act the way a board of equalization acts, which is a much easier thing to do. What a board of equalization does is to let the local assessor assess property then in the following year after the local assessor has stuck his neck out and said this is what it's worth, then the board keeps a record of all sales that take place in the following year so they have the benefit of hindsight. They then take the sales and compare them with the assessed valuation which is essentially the assessor's prediction of what the sales price would be if a sale took place. Then if the assessor is assessing everything about 50 percent of the market value then they simply double the figure to bring it into parity with others. They may find one assessor at 33 percent. Then his figures or tripled

may find an assessor at 75 percent so they add $1/3$ to his figures and so on up and down the line to bring them into parity with each other. This is so that the state and country property tax levied on this basis will be fair among different assessment jurisdictions.

What I am suggesting is that the Federal Government needs to do the same thing as a state board of equalization in order to check up specifically on land assessments because when the local assessor under states land values relative to building values he makes it possible for local people to avoid paying their federal income taxes by letting them depreciate a large share of the land value for the purposes. To give a numerical example: Suppose a benchmark assessment of land would lead you to say that ninety percent of this parcel of real estate is land value and 10 percent is building value. Whereas the kind of assessment we have in many jurisdictions today would say it is 50-50. Why under the benchmark assessment the taxpayer could only take 10 percent of what he paid for the property and depreciate that for income tax purposes. Under the present system he could depreciate 50 percent for income tax purposes. So under the present system he is depreciating land and he is getting away with murder.

The amount of money the Federal Government loses each year because of this practice is several billion dollars. It is a big thing and the Federal Government has a very clear and pressing interest in doing something about it for its own sake, regardless of its effect on local taxation.

2. But in addition, if the Federal Government forced local assessors to assess land properly, then you would also change the effect of property tax on land use in each locality. Thus a dual effect.

3. Now, let me just add to that that one of the big problems we have today owing to the fiscal zoning sort of motivation. Every jurisdiction is trying to keep out poor people, because they regard them as fiscal deficits. They cost more in sending their children to school than they pay in taxes. From the point of view of many localities, they are perfectly rational. They (the locality) are just responding to the incentives that the system puts on them. But it is the business of central government to change the incentives that they feel so they will act differently. So instead of competing to get rid of people they will compete to attract people.

One way that local jurisdictions behave when they are trying to keep people out is to put a low assessment on land and a high assessment on buildings, especially new buildings.

JOHNSON -- How does this effect the consumer? Does it raise rents?

GAFFNEY -- Yes. It keeps the poor out of the community. It cuts down the supply of buildings and it encourages people to hold land off the market. There is kind of an unwritten truce between the assessor and the land speculator. The assessor says in effect, I will keep your assessment way down low and you keep your land off the market so it isn't developed and doesn't bring in school children. There may be an element of racism in it many times and a man would have to be omniscient to know which is the paramount factor. Sometimes it is one -- sometimes it is the other. When there are various forms of ethnic bases, then

there is just cause against outsiders and newcomers which just might upset the political balance of power. There are all kinds of illegitimate reasons people have for trying to keep out outsiders. All of these come to focus in the under-assessment of land which always has this effect. So there is a very clear interest of the central government it seems to me. In avoiding picking on one at a time, it seems much more sense to apply pressure to everybody at the sametime uniformly. This would be done by adopting a federal system that would cause even assessors to change their practices of assessing land so as to bring it up and take it easier on buildings and apply a uniform pressure to open up each community. This would also do great things for the building business and also should increase transactions in real estate which should make the brokers happy. Basically, of course, it should increase the supply of housing and other life support systems which is really the object of the economic life anyway.

JOHNSON -- Off the cuff -- what effect would the benchmark tax have on the financial institutions?

GAFFNEY -- Well, that's a good question. It would effect them in two different ways: (Just as it would effect brokers in two different ways.)

1. Looking at the brokers, it would increase the volumes of business and probably reduce the unit price at which a transaction took place. Therefore, it would force them to stop catering to the carriage trade and act more like Sears/Roebuck. Similarly with the banks. Some banks will be nervous about it because increasing the supply would tend to bring down the price, then some of their marginal loans would go bad. If they have been letting people mortgage out which they

are not supposed to do but many have done ... if they are skidding along on very thin equities some banks will be stuck with property which they will have to foreclose on if the market fell about 10 or 15 percent. And so they will resist that.

2. On the other hand, it would increase the demand for loans. So far as the new business went they would be better off.

The banks would leave a little security on their old business and expand their total business. So it's the same story you get when you break a monopoly -- lower price - greater volume.

JOHNSON -- One of my big questions about the use of a benchmark tax is -- would said tax break the present structure of loan lending (and FHA support) in areas of housing and development based on so-called security of the individuals, security in their prospective earning power. They look for stability and we have observed that certain classes of people normally fit these qualifications and these guidelines in our society. As a result of which we have pronounced segregation in housing developments, which are segregated racially, segregated economically and segregated educationally.

How would the mechanism of a benchmark tax loosen such an institutionalized practice?

GAFFNEY -- Well, that is a very big question. I can only comment on parts of it. In general we have a system of credit allocation now where you can borrow money if you can prove that you don't need it. The effect of changing the tax system is to change the creditworthiness of individuals. People whose taxes go up will become less creditworthy, and people whose taxes go down will become more creditworthy. Right now by taking it easy on land we make land owners more creditworthy and by putting heaviest taxes on new buildings at the time they are put up, we make enterprising people (and the consumer) less creditworthy.

Now, one of the ideas to changing the system (in addition to everything I have already said) would be to change the behavior of lenders so they would look less to land as the basis for credit and more to other things; which would be the value of the building first of all and secondly, the qualities of the individual who is owning the building -- whatever those qualities might happen to be. This would involve them in more work I suppose, it is much easier to say -- well, if it's in a certain neighborhood, then it's a good piece of land and we'll lend on it.

JOHNSON -- The land owner is currently being taxed very low on this land in question.

GAFFNEY -- Correct, if you have to pay more taxes on land and less taxes on building then (hopefully) lenders will respond to that. Lenders are always going to accentuate any trend, in other words, as you get richer you also become more creditworthy and vice versa. So, to sum it up, I would say that the behavior of credit institutions would simply serve as a multiplier to accentuate all the trends we have been talking about.

JOHNSON -- The mechanisms involved in implementing a benchmark tax -- can you elaborate on specific anticipated problems? Particularly the problem of census taking.

GAFFNEY -- Oh, yes! Starting in 1955, the U. S. Census of Governments has engaged in an activity that is essential to what would be done by a board of equalization; that is they have recorded sales that took place and compared them with assessed values that were put on the property by the assessor before the sale took place. They have done this for the entire United States and published it in 1957, 1967 and now a 1972 data which should be coming out soon. I think they did one between 1957 and 1967, also. But at any rate, their 1957 and 1967 publication is considered a definitive work in the field, and it's of high quality. And I would conclude from this that the Federal Government is quite capable to do this job of preventing competition under assessment.

The Census of Governments job could be greatly improved, and they (the people who did it) I am sure, would agree. If we got into that, I would have a few specific recommendations to make. But the U. S. Census of Governments came up with some conclusions which are relevant, in fact, they are the most definitive source of the conclusion

that land is under assessed relative to buildings -- that finding stands out throughout this report (the 1957 and 1967 reports of the U. S. Census of Governments, Vol. 2, entitled, Taxable Property Values).

JOHNSON -- What specifically is the 1967 published data of the U. S. Census of Governments? Should the Subcommittee pay particular attention to . . . ?

GAFFNEY -- Well, the report classifies property into four or five different types. (1) residential, (2) acreage and farms, (3) vacant lots, (4) commercial, and (5) industrial. The above information is given by states and counties. The data interprets:

1. the ratio of assessed value to sales price of sold property,
2. state wide average weighted according to size.

The data will show percentages of assessment to market value; for example, if you take Kentucky vacant lots and assessed 58 percent of market value and opposed to 80 percent assessment for residential. Using data like this, each jurisdiction could be connected at the federal level. So when a taxpayer goes into IRS and says he should be allowed to depreciate half of his property because it is half building and half land, then the IRS can say, well, in your locality the assessor has the land only half as high as he ought to. Therefore, we will double that and instead of it being 50 percent land, it is now 100 percent land, and the building isn't worth anything.

Now, the above is a very crude example. It would have to be refined for different classes of property and other things like that. But the U. S. Census of Governments document indicates that it can be done. The thing that makes equalization easy, so it can be done at

the federal level without getting into insurmountable problems is that it is always done after. The assessor has to do the handwork, and all the equalizer has to do is come along later and take that small percentage that sells in the following year, and see how the assessor did and make a correction accordingly.

This, it is a foolproof method of checking up on the local assessor and can be done with a fairly small staff. So it is a feasible operation, the census has already done it, and it has been done at the state level for years -- so I think it's a very simple thing to put into operation.

JOHNSON -- Thank you, Dr. Mason Gaffney.

Sir, at this point can you think of anything else that should be thrown in that the Subcommittee should be made aware of ... arguments, and etc. ...?

GAFFNEY -- There are dozens of arguments for and against such a taxing system, although I am not sure how much you want to clutter this up with related issues.

This concept (benchmark taxation) is a pretty fundamental thing which affects many aspects of life. It certainly affects city layout for example and efficiency of the provision of possible services. But, that is a big subject all by itself.

In general, it tends to encourage higher density and, in my opinion, you get much lower cost per unit at higher density. Also, mass transit becomes feasible where now it is not economical.

It (benchmark tax) would have an effect on pollution, on the environment

JOHNSON -- I think arguments are important, because many good ideas have been lost to society through the failures of those introducing the ideas to anticipate the opposition.

GAFFNEY -- Well, I am sure any idea in going to be both attacked and advocated on dozens of grounds, depending on the standpoint of the person.

Some people are going to say, "what effect will it have on skiing in the U. S?" You therefore, cannot anticipate everything. But why not try to list the most important things.

1. Environment
2. Employment
3. Transportation
4. and the efficiency of urban public services and the cutting down of urban spending.

GAFFNEY -- What else do you think would be top priority item?

JOHNSON -- Well, I think the effect of increasing urban density would have the effect of pulling the suburbs back into the city.

GAFFNEY -- I would think so. (Well, lets take it from the top.)

The first was environment. I can think of six or seven ways it would effect environment. But just let me mention two:

1. By bringing people back in towards the center of the city, it would also bring the environment closer to the center of the city. That is to say, the open space which you now have to drive 20 miles to find would only be ten miles away, if the city were that much closer.

2. You would lose a certain amount of what is presently called open space near the center of the city. For instance, as you do have now large estates very close to the downtown occupying several acres of land.

JOHNSON -- That's not really open space. In any case, that's not public space.

GAFFNEY -- That's only open space for the benefit of the few people who live there. So I would agree with you that that is not a great loss. But some people would regard it as such. Though I believe mistakenly.

At any rate, some of that would be lost.

I think the gains would be greater than the losses. One reason for this belief is the reduction of dependency on private motor cars as a means of transportation. You would definitely get a boost for mass transit and a decline in the importance of the car. As a result of increase in density.

JOHNSON -- Do you then anticipate General Motors and other auto manufacturers lining up and lobbying heavily against any proposed benchmark taxation move?

GAFFNEY -- Yes, I am afraid so. That is a very good point, they would be very powerful opposition. For the reason you mention and alot of ancillary reasons that I might tick off.

One is that gasoline stations and automobile dealerships are two of the most underdeveloped kinds of land use that we have. Also, under our present tax system, they are the most undertaxed as far as the local property tax goes. Now, a gasoline station will cost about \$10,000 new. The site which it is located, which if its in the city takes half acres, will run almost always more than \$70,000. If it is a good hot corner, it might run \$200,000 or \$300,000. So the ratio of the building to the land there is very low -- something like one to five. So, if you shift off to the land basis, gas stations are going to pay a lot more in taxes. Half of them are going to be sold for some other purpose.

This is one of the hidden ways in which we subsidize the motor car presently.

Now, parking lots are another thing. If you look out my window (1700 block of Massachusetts Avenue, N. W., Washington, D. C.), here half the land that you see is in parking lots. Well, those cars are not taxed under the property tax or any other tax for that matter. They are virtually tax free. If a building were there instead of those motor cars, it would be taxed. (That is federal tax on autos).

Now, a shift to a land tax will mean parking lots will pay more and will either give way to other use or improved parking structures, etc. But on the whole, parking rates will go up in the central city. And the use of motor cars will be discouraged.

Now, auto dealerships are another example of poor land usage, they are just parking lots for inventory on valuable land. . . . Well, these either belong to or are controlled by the major auto companies, and the gas stations are either owned or controlled by the major oil companies.

Of course, we could get into Safeway and Giant. Also which consist of big parking lots on valuable land... They are going to be against any form of benchmark tax also.

So, it doesn't take too long to identify who is going to be hurt, who is going to live up against it, and who has lined up against it in the past. So the opposition can be identified.

JOHNSON -- Under the topic of transportation . . .

GAFFNEY -- Well, yes, if you shift more emphasis to the land part of the tax you will, as we were just saying, discourage the use of the automobile. At the same time by increasing density (bring people closer together geographically) you will increase the use of mass transit. On the whole this will be in the direction of reducing pollution both carbon monoxide and noise. This will improve the environment in addition to the fact it will bring the outskirts of the city much closer in. As you put it, bring the suburbs into the city. So your farm land and low density park land can be much closer to the center city than it is now.

Another environmental factor which we have not talked about has to do with how fast buildings are replaced. For example, we have a smoke and incinerator problem in the District of Columbia. If you look at where the smoke comes from and where the old incinerators are, they tend to be the older buildings.

Now, what would result by going to the benchmark systems of taxation would be the acceleration of replacement of old buildings by new ones. Generally speaking, that means getting rid of sources of pollution and sources of pestilence too.-- rats, bad paint, fire, etc. All these things are associated with older buildings.

Now, getting back to the question of distribution of benefits. Every time you knock an old building and build a new one, if you look at it in the small, you are taking land away from the poor and giving it to the rich. But, if you look at it in the large, you are increasing the supply of buildings and bringing down the general level of rents. So, that^{is}/an issue that has to be faced up to. In general, I think the answer is, if the new buildings come in at higher density than the old you are going to increase the total supply of floor space and total number of dwelling units.

What's been happening in this country for the last thirty years is just the opposite. Everytime we put in a new (well, not every time, but more often than not) buildings we reduce the density and this throws people on the market and increases scarcity.

The effect of the proposed benchmark system would be the other way around. It would tend to increase density and increase supply for any given area.

On top of that, I think it would be safe to say that presently it could increase the supply of buildings in almost every American city by a very large factor without knocking down anything at all, because there is so much vacant land that is already cleared. By the urban renewal process and a lot of other things which are going on. The unpleasant part of this has already taken place.

The kind of urban renewal we have had (in so-called slum and land clearance programs) have had entirely too much emphasis on getting rid of the old without enough emphasis on replacing it with the new. Thus, they have left us with a large inventory of bombed out land which needs to be redeveloped and can be redeveloped without hurting anybody. So I don't think we need to worry about the question of poor people being driven out of there old homes for a long time to come. We have already been through that.

JOHNSON -- Well, what about the proposition that a benchmark tax will cut down on the city's operational overhead . . . thus through lessening the cost of supplying services to the consumers?

GAFFNEY -- This is pretty much the same principle or extension of the same principle where higher density makes mass transit economical where it isn't otherwise. By the same token, it makes public water

supply economical where now density is so low you have people using private wells. It makes public sewers economical where now density is so low you have private septic tanks.

Now, if you extend this principle a little bit, suppose density become high enough so you can afford to put in a public water supply system -- now let's double the density above that level and you increase the cost of public water supply system say about 50 percent. You have doubled the number of people served, so the cost per customer gets much less. This is pretty much based on the geometric principle that the area of a circle increases with the square of its radius or putting it in terms of the cross-section of a water pipe -- if you double the circumference which doubles the cost and the amount of material in it, you have increased the capacity by two square or by four. So you double the cost and quadruple the capacity. This holds true almost indefinitely.

JOHNSON -- Another argument that is moving at me is -- most popularized studies on "crime in the streets" advocate reducing the density of the center city in order to make for a safe city. Although Jane Jacobs argues for higher density and mixed usage of land as a means of curtailing violence in the cities.

GAFFNEY -- I believe that (the notion of reduction in density leads to safer streets) that's a mistaken notion. I can think of two or three reasons.

Number one, any study that's ever been made of the relationship between crime and density that I know of has failed to correct for

other factors like the age of the buildings. Now, if you have people living in old buildings at higher density and compare that with new buildings at lower density, you may get a lower crime rate in new buildings at lower density, but the lower crime rate is more likely to be because they are new rather than because of the lower density. In terms of vulnerability to crime low density buildings are harder to defend.

For example, in White Fish Bay, Wisconsin, where I lived before moving here to the District of Columbia, the break-ins were concentrated in the mansion area where the density was the lowest. Were people live pretty close together there's some protection from crime because citizens surveillance and the Jane Jacobs effect.

Now a second angle here that I think is terribly important is that most police cost and most of the time of policemen is not spent tracking down murders and rapists and muggers, but is spent in the care and feeding of the automobile. Now, it is hard to look at police budget, but I have looked at court records in Milwaukee and I can remember some figures that stuck in my mind: In 1967, there were twenty convictions for murder, 26 for rape, and in that same year there were 50,000 moving vehicle violations and 206,000 parking tickets. This gives me an idea of how policemen are spending their time. The automobile which accounts for most of that budget

Well, you may say murder and rape are more important, but I don't think that's true, because if you get hit by an automobile you are just as dead as if you are stuck with a knife. And the number of people who are killed by the automobile each year is much greater than the number who are raped and murdered. So I would be inclined to say that the worst sort of crime we have is in the streets. We have the automobile accident record. Anything which cuts down on the automobile usage and replaces it with a safer form of transportation is the most important thing we can do to cut down crime in the streets.

JOHNSON -- That is a very interesting argument for benchmark taxation, Dr. Gaffney. I assume you think the subcommittee should have little trouble in documenting such an argument?

GAFFNEY -- Oh, yes. I think you could come up with some great numbers with that.

JOHNSON -- Dr. Gaffney, on behalf of David Martin, myself and the Senate Subcommittee on Antitrust and Monopoly, I thank you for an informative interview.

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NOTE: 1. Attached Bibl.
2. Recommendations