



Tapping Land Rents After Prop 13

By Dr. Mason Gaffney

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Mason Gaffney

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TAPPING LAND RENTS AFTER PROP 13

by

Mason Gaffney
University of California
at Riverside

INTRODUCTION

A traditional saying, such as Polonius might lay on Laertes, is this: "Never marry for money. But you might marry where money is." California public treasuries today are where money is, surrounded by taxable surpluses in the form of high and escalating land rents -- "fat in the private sector," it has been called. Prop 13 bids them forbear taxing it. But it's all right to tax where the rent is. So long as the rent is there, and taxes are shifted to landholders, there is a taxable surplus.

I am not writing to ease the way for big spenders. During the late energy crisis Amory Lovins, a repentant nuclear physicist, proclaimed the greatest source of new energy is "Negawatts," meaning watts not wasted. Likewise, a great source of public revenue is "Negabucks." "Negabucks are Megabucks," is my text.

Here is one example as a foretaste. Water in this arid land is a limitational resource whose market value, were a true market allowed to develop, would rise. By rising it would pull away a share of the rent now imputing to land surfaces -- the resource conventionally called "land," held in fee simple and subject to property taxation.

Water probably belongs to the State, if we are to believe the Constitution and the Water Code. Water is a rent-yielding resource. The State could lease it for the market rental value, raising large revenues which it could share with localities in its wisdom. Instead, the State and Federal governments subsidize water withdrawals: Negabucks to the Treasuries, where they could raise Megabucks.

Consider the overdrawn Colorado River. Every major user sucks from it through a straw subsidized by others: the Colorado Aqueduct and Hoover Dam; the All-American Canal; the Wellton-Mohawk Canal; the Granite Reef Aqueduct (CAP); etc. The solution, clearly, is in the slogan "Megabucks for Negabucks." Stop the subsidies; start the taxes or rent charges. As a happy

by-product we would eliminate the water shortage overnight, and probably slow down the tide of immigration which is overwhelming the infrastructure we cannot afford to expand, upgrade or even maintain and renew without more public revenues. That observation is nothing but the theory of marginal-cost pricing applied to California, 1988.

You perceive I write as an economist, not an elected official. Every untapped tax source is someone's sacred cow. It is our sacred cows that eat us out of house and home, and elected officials live by or off sacred cows. So you may say "But you can't touch that," or "My mother-in-law would flip," or "Sacramento is too crooked". Maybe so, maybe no. But I do observe the world changes every year, surprising us every two years or so (and the CIA every month, it seems). The presence of big deficits and big problems guarantee^s big changes ahead. Let us therefore keep shuffling the options. I'm just here to show where the treasure is buried.

It is buried in the land, mostly. In aⁿ open economy the after-tax rate of return to capital is set in world markets. Arbitrage will keep it the same, regardless of any local taxes. Disposable real income of wage-earners, likewise, is controlled at regional levels by migration. Thus if there is no land rent there is nothing to tax: all other factor supplies are elastic and any tax on anything will make them go away.

Only land is immobile among taxing jurisdictions, which are defined as areas of land. John Locke, Francois Quesnay and others long ago deduced from that that all taxes lodge in land rents, in open economies. It is known as the Physiocratic doctrine of tax incidence.

The most efficient way to tap land rents is through a tax based on something other than functional productive activity, a tax that aborts no marginal effort or real, macro-economic investment like creating capital. The property tax based on land value is such a tax, of course.

Prop 13 caps it at a^t 1%. That is the source of our problem. But Prop 13 does not proscribe less efficient taxes, taxes that might impose some marginal disincentive, some "excess burden." There are those who favor these anyway, because they consider participation and risk-sharing to be better ways to assert what Walras called the "co-proprietorship of land by the state." Maybe they are partly right. Certainly many private landlords write participatory leases in preference to fixed cash rents; maybe the fisc should develop this option, too. In California today it has no other choice.

SALVAGING SOMETHING FROM THE WRECKAGE OF THE PROPERTY TAX

Like Robinson Crusoe after the wreck, let us first see what we can haul ashore from the grounded vessel.

Utilities and Rails

The California Supreme Court seems to have endorsed assessment discrimination against utilities and rails which are state-assessed. In the 1960s the Assessor of Sacramento County brought all other assessments up to 100% (a mandate of the State Constitution), with the incidental effect of reducing the share of taxes paid by State-assessed utilities. The Court ordered Assessor Irene Hickman to reduce them below 25%, to avoid upsetting a delicate Statewide balance between utility assessments and local assessments.

The message is clear that the Court will support the use of utilities as devices for collecting taxes. Overassessments of utility property are automatically shifted forward to ratepayers in the regulatory process. What Assessor Hickman threatened to overturn, and what the Court upheld, was an implicit compact for shifting property tax burdens from extensive to intensive users of land, and also inducing localities to spurn the temptations of public power.

The major asset of rails and utilities (other than non-utility property held by their holding companies and subs, etc.) is the ROW, (plus, for utilities, the siting permit and implied easement to pollute and endanger vast areas around them). ROW is a natural resource of paramount value, a value enhanced by use of eminent domain and grant of monopoly franchises. ROW is like a public street or highway, only it is granted to a private firm. Rights of way joined in networks enjoy a unique form of plottage which raises their value high above alternative use, historical cost, or other traditional bases of assessment. ROW is not an invisible, but an unperceived natural resource of enormous value.

Few parcels of private land are usable for much without utility service today. Utilities are monopolies under public regulation, or sometimes ownership. They are allowed to discriminate among consumers to tap "consumer surplus". Rates need not always be "cost-justified," they may be based on "value of service" as opposed to cost of service. What a promising device for transferring land rent from highly rentable sites to utility revenues and hence to

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public revenues. It will never match land taxes for simplicity, but economists love price discrimination schemes: here is their chance.

Economists often reason that taxes on rails and utilities are ill-advised because these are decreasing-cost services. There is an important truth there, but also much hokum. I will return to sort that out later.

Reassessment at Time of Sale or Improvement

When Donald Bren bought the Irvine Company for an alleged \$1B the Orange County assessor, using comparables, decided \$3B was the proper tax base. After some court cases the final compromise is closer to the assessor's figure than to Bren's. Riverside County is in the midst of an analogous suit with Bedford Properties, the new owners of Rancho California.

The point seems to be that a firm whose strategy is to sell slowly can be assessed on an optimal rate of sale assumption, resulting in ^a higher tax base.

With corporations which never die, and may therefore never transfer land, there may be a long wait for reassessment. The clever assessors, however, have established that selling a substantial bloc of stock triggers a reassessment under Prop 13. Of course this was contested but the assessors have made their point. Gradually we may push this further to the ultimate point that any sale of stock should trigger reassessment. Some people believe that discrimination against corporations is long overdue, considering that they are inherently a union or combination of capitals acting in concert, free of personal liabilities.

New construction triggers reassessment under Prop 13, but only of the new building or addition. The only rent-tapping this facilitates is in oil fields, where expansion of reserves is treated as new construction.

Split Roll

This is a promising route back from Prop 13, the "homeowners' revolt." If it really was for homeowners there is no reason to exempt non-residential property. There is not even any reason to exempt rental residences, experience now joining theory to refute the notions that Prop 13 would lower rents charged to tenants, or end homelessness, or abate the housing shortage.

A split roll would classify real estate by use, or planned or zoned use, and impose a higher tax rate on non-residential real estate. There is an understandable concern that higher taxes would drive out industry, but to that

there is a simple, classic solution: exempt structures and just tax non-residential land at a high rate. Since an amendment is now required anyway, this requires no more electoral expense, just the change of a few words. The needed words have already been written: Assemblyman William Filante, Republican of Marin County, has a bill all drafted.

While we're at it why not limit the land value one can claim as a primary "residence" closing an obvious loophole, raising more revenue, and releasing sterile land for commerce and industry. Aliens with palaces in Beverly Hills might as well contribute their mite to our public services.

One of the many "unintended" results of Prop 13 was to cut revenues from oilfields. California is the one state with no severance tax, owing to its traditionally higher property tax applied to minerals in the ground. While splitting the roll we could consider splitting it twice^{or} more, as Minnesota does, with higher rates for those industries, like oil, yielding more rent. It would also be an occasion to take this revenue at the State level, instead of leaving it to a dozen lucky enclaves.

Special Districts

Most special districts levying zone-of-benefit assessments are exempt from the Prop 13 cap, both on rate and base. This is because an "assessment" is not a "tax." Presumably it is not a "tax" because it is limited to benefits received, narrowly construed (like "what have you done for me lately").

Yet some benefit districts have exercised broader power. Irrigation Districts, perhaps the earliest kind in California, are allowed to collect for "indirect benefits," and to levy ad valorem without demonstrating specific benefits. They have their own assessors and are not bound to use County assessments. They may not tax improvements, only land. They provide city water, generate and distribute power, manage ground water, and one has even run an airport. All residents vote, and there is no cap on their rate. They are a product of the single-tax era in California and they show it.

There are dozens, perhaps hundreds of variations of special districts in California, and new variations are often brought forth. There are "1911 Act" districts, where each bond is secured by a single parcel; and "1915 Act" districts where bonds are collectively secured, and assessments collected with general property taxes. After Prop 13 the beneficiaries front a reserve fund to guarantee payments, and new accelerated 90-day foreclosure is possible.

These districts can bond for most street improvements like sewers, water and even electric lines, where public. They may also specialize in operations and maintenance. There are fire and police districts. There are even mail districts.

Flood control districts are common. Prado Dam on the Sta. Ana River was paid originally by assessments on parts of Orange County, the major area protected, and Orange County is being pressed today to do it again to raise the Dam. As Federal porkbarrel spending declines, as it must, local districts will be pressed back into service.

Several familiar public works have been district-financed: the Broadway Tunnel of San Francisco; the Golden Gate Bridge; Don Pedro Dam on the Tuolumne; Exchequer Dam on the Merced; Hemet Dam in the San Jacinto range; and so on.

Mass transit may be financed by transit districts under the Mills Act. The Los Angeles subway is now being so financed, in part.

Front foot assessments are common for some street improvements; area assessments are also possible. Assessments may vary with costs, as estimated by engineering consultants lacking any particular legal or political standing, and various concepts or even screwy notions of cost are possible. These notions could get quite close to land value: for example costs might be seen as proportional to a site's ability to generate sales, or attract traffic.

Some 20% of all property-derived revenues in California today come from special districts. There is "space" for great expansion of these. Many cities are now sponsoring districts to replace expenditures now paid from the general fund, thus releasing funds for other purposes. "Money is fungible," as economists like to say.

Some proposals may be quite comical and inept, politicians being what they are. Riverside City Council, for example, recently nearly created a street lighting district to pay for a new performing arts center. The particular idea failed, but more popular expenditures are on deck and the district is now being formed to fund new police positions. It is likely this trend will accelerate as councils and voters and developers climb the learning curve. Currently many consultants and lawyers in the field treat their knowledge of public law as a private monopoly, so the institutional know-how has not been widely known or cheaply accessible.

Groundwater districts come in many variations. Where water is exported from a basin, as it is from the Bunker Hill Basin in the Sta. Ana River, the

zone of benefit extends widely. Districts not only manage basins, they allocate groundwater storage space, a natural resource often comparable in value to water itself. Like anything else of great value this is a potential source of public revenues. "What can be regulated can be taxed," one would think, for to regulate presumes sovereignty. If a District can regulate an aquifer, it can tax it, and/or be taxed by the sovereign state whose sovereignty it has borrowed.

New Ways of Tapping Property Without "Taxing" It

Los Angeles has tried to assess land, but not land value, in order to raise revenues for more police in zones of special need. Any thimblery formula is legal so long as it is not ad valorem: but it must win 2/3 of those voting. In 1981 L.A. tried for an assessment based on lot area; later on a modified formula. Both failed, but not for being illegal.

Orange County has tried for a fee of about \$1/sf per new home and four times that for new commercial space, to finance a new Foothill Freeway. Earlier it tried a 1¢ sales tax, which failed. There are Community Service Districts that use annual parcel fees.

Developer fees are most popular now, and proliferating and escalating rapidly these days. Of these there are four points to make.

1) They are shifted to speculative landholders, not shifted forward to buyers as often alleged. Self-serving claims by developers have confused this issue terribly. They typically run like this: we already pay the full cost of serving new lands; if you make us pay we will shift it all to buyers; and it will destroy the development value of our land. Only the last of those is correct, and it refutes the first two. They are indeed a levy on property.

2) But they are just a one-time levy. They are beloved by myopic officeholders because they yield quick cash today. Herein lies a grave danger in the parlous world of politics-as-is. It leads to improvident annexations to improve cash flow now, at the expense of huge future liabilities with no added revenues to cover them. What revenues will maintain the new sewers, and replace them down the line? It is like going into debt. Developer fees and imposts are dangerous to substitute for the old property tax which yielded sustained and slowly rising revenues in perpetuity.

3) They are based on the dwelling unit, like a hearth-tax, and penalize high density.

4) They let the richest go scot-free. The high rents of the CBD and the beach and the Beverly Hills are barely touched. They do little to refute the charge that Prop 13 breached the prior social compact and left us with taxes on youth and upward mobility.

Reducing and Removing Exemptions

Before Prop 13 already the property tax was riddled with preferences and exemptions: not so severely as the income tax, to be sure, but too much at that. These could now be removed.

1) 2nd-growth timber has long been exempt. The case for this, if there ever was one, was the ^{tax} discouraged reforestation. It was arguable when tax rates were 3% and interest rates 5%. Now, with tax rates 1% and interest rates 11% one cannot blame or credit the tax with much effect.

Land under timber is virtually exempt, being assessed solely on capitalized income from timber, which is near zero. This is to keep recreationist bidding from raising timberland assessments, a provision mainly aiding a handful of giant absentee landholders like Sta. Fe-SP of Chicago; Simpson of Shelton, Washington; Horowitz of Houston; etc. These two timber preferences could be repealed.

2) The Williamson Act seems redundant after Prop 13, even if (which many would challenge) it was a good idea once.

3) California golf courses are assessed on capitalized income. Many are held by non-profit corporations with, by definition, no income. Thanks to the exemption many new courses are opened every year, many in the Sonoran deserts of the Coachella Valley, soaking up lakes-full of our allegedly scarce water. One media baron and friend of presidents, Walter Annenberg, even has his own private course here, although his primary residence is Pennsylvania.

Country-club memberships, not recognized as taxable property, trade at fancy prices, yielding their owners tax-free imputed income and unrealized capital gains. I enjoy golf, too, but this is ridiculous. Few would pay the green fees required to preempt all those resources were they priced on a level playing field. All told the loss of tax-base is very high, and without redeeming social merit unless one is an incorrigible snob (which of course many are, which is how we arrived at this pass). Billiards are much cheaper, and intellectually rewarding. A deep understanding of billiards will help one pass Physics. Rolling dice is at the core of Statistics. But golf gets the subsidy, it helps promote real estate.

4) Churches hold less land than common legend would have it, and perhaps with more non-pecuniary returns to the community. This is not the age of Henry VIII or Luis Rizal.

5) Cemeteries? That's different, although it varies with the city. In industrial-dependent Milwaukee, Wisconsin, cemeteries preempt more space than all industry, which may help account for the city's 20% population decline since 1960. Cemeteries remain one of our more sacred cows, but in this rational, secularized age perhaps we could summon the courage to relocate some ashes and bones to cheap land. San Francisco long since relegated its to the suburb Colma.

6) Redevelopment Districts, a good idea gone wrong, have now become scandalously so and should be abandoned forthwith.

7) Public land could with benefit be taxed. This might seem a zero-sum game, but think about the motives of bureaucrats. Once they acquire land it never again appears in the budget, even the allegedly zero-based budgets we sometimes see. They squander it. They speculate shamelessly, indeed proudly, proclaiming their "foresight." Churches are small-time exemptees compared with public institutions, including the ones most of us work for. I could cite numbers but I've made enough enemies this week. Still, charity begins at home and it might even help employees like us for employers to disgorge land and spend the proceeds on staff.

EXTRACTIVE RESOURCES: SEVERANCE OR NET PROCEEDS TAXES

Oil and Gas

California, unlike other oil states, imposes no severance tax. We did and perhaps still do an outstanding job of assessing minerals for property tax, but at 1% that hardly matters any more. A severance tax also shifts revenue to the state level, sharing rents more widely, instead of focusing them on odd places like Taft, McKittrick, Huntington Beach, Long Beach, Kern County and Culver City. Production is not labor-using and local people have no peculiar claim on the value, either individually or collectively.

To tax rents successfully two things are needed: the tax base must be a source of rent; and the taxable event must not be defined in a way to destroy or abort rent.

As to the first, oil and gas are sources of rent. California was a major producer at the lower price levels before OPEC. We have much old oil in known

fields. The investment value of those fields has caused them to move into very strong hands, with many transactions at high prices among Tenneco, Shell, Texaco, Getty, Arco, Unocal, Occidental, Chevron, etc.

On the second point a severance tax is not perfect, its base is too gross. It is not exactly "off the top" because it is net of all costs of surface storage and horizontal movement after the wellhead or "Christmas Tree"; but it allows too few deductions before that point. However the nature of the resource makes that tolerable, for these reasons.

High royalty rates, taken off the top, are common within the industry itself, indicating that private contracting parties are not much concerned with these marginal disincentive effects. That is because the elasticity of production is low, especially during the flush early years of production. The marginal product curve of production effort applied to a fixed deposit is Matterhorn-shaped, with a steep slope at the cutoff point. So one can remove a large percentage off the top without moving the cutoff point much to the left.

Unproduced oil is not lost but merely deferred, for which there may be social arguments anyway.

After the flush early years when the elasticity of production rises, royalties are normally negotiated downwards to avoid premature cutoff. Severance taxes may be structured the same way.

Severance taxes would normally be shifted to landholders in the form of lower royalty rates, offsetting the marginal disincentive of the tax based on units-of-production. One variable cost falls to accomodate another; the fisc simply displaces the fee-holder.

Exploration is heavily subsidized by federal income tax provisions, so if our tax should cool exploration by diluting its rewards that would not be a net social loss. We would be levelling the playing field, not tilting it. Other arguments for slowing production are the common pool problem; air pollution; national security; overcrowding of highways; and several other subsidies both to production and consumption of energy. We can compensate for these allocative errors and raise revenue at the same time.

Oil and gas are closely held by a few corporations. Corporate stock is generally closely held and, along with real estate, is the heaviest item in the portfolios of the wealthy. Severance taxes generally have a levelling effect on distribution, therefore. In additon, many or most shareholders live

outside our state. Transferring rents from them to our fisc, spending the proceeds locally, improves the state economic base and balance of payments.

Finally it is standard practice to improve severance taxes, abating their marginal effects, in three ways: imposing a sliding rate based on flow, or other proxy for rentability; dividing properties into rate classes based on use of major known recovery techniques, with lower rates for secondary and tertiary recovery; modifying the base to "net proceeds," with more deductions allowed for lifting costs "before the Christmas Tree."

Offshore oil and gas is outside state sovereignty and escapes all state and local taxation. One result is unbalanced state hostility to offshore leasing, for the locals suffer the degradation without sharing the gains. Some provision for state sharing in offshore revenues seems indicated.

Water

Here is a high potential to turn "Negabucks into Megabucks" for the treasury. Water is underpriced and wasted. There is strong support for a groundwater extraction charge, purely as a conservation and efficiency measure, and to obviate megabuck "rescue" projects. But there is also revenue potential. In an arid land, water is life. Some, perhaps much of the land rent now imputing to fee simple lands can be transferred to the holders of water, simply by raising its price.

Legally, water belongs to "the people of California." A license to withdraw the people's water is not real property, and is not sheltered by Prop 13. The State can serve free market efficiency and raise revenue in one stroke by putting a charge on water withdrawals. Such a charge would not prevent, but would expedite the powerful current movement to market water.

An economic charge should of course be geared to the economic value (locational, mainly) of waters. Groundwater has been mentioned. Surface water could bear higher charges because it is already at the surface with no pumping. This charge might be called a "tax," or a rental for state property, as legalism and politics may require. The charge should cover not just active withdrawals but rights to block withdrawals by others.

Geothermal

Superior resources should bear an extraction charge. Failures in Imperial Valley point up the lack of value in some geothermal sources; high values near Santa Rosa point up the rentability of others. In 1984 a source near Santa

Rosa went from Occidental Petroleum to a Kuwaiti owner, as part of the trend toward Banana Republicanization of this highly rentable state, for \$350 millions.

Timber

Forest^a management practices in California are now so heavily regulated by the State that taxation is less an allocative and more a distributive issue than before. Yet timber in California is virtually tax-exempt, for no very compelling reason. All the major holders are now absentee corporations, large and wealthy. A high tax on net proceeds seems indicated. Early write-off or outright expensing of replanting costs would preserve and enhance needed incentives to reforest promptly.

Clay, Sand and Gravel

Rather than catalogue all of California's many minerals, each with its own wrinkles, I just mention humble clay, sand and gravel to be sure they are not overlooked. In total impact they are a large industry. To hold key deposits in growing areas is to win highway contracts. There is big money in humble silicons, and more of it could well line the state treasury.

RENT FROM PUBLIC LANDS

Streets, Highways

30% or more of the land in cities is in streets and highways. This land is worth as much per unit as the adjoining land it serves, and often is crowded while private land is not. The possibilities of charging vehicles for crowding the public space are virtually untapped: parking meters and fines just scratch the surface. Now that the private lands are nearly tax-exempt it would seem the public should start charging more for the use of public ways. The case is often made on pure efficiency grounds, but the revenue potential is formidable. Private land is hardly usable without access to streets, and the public may set the terms of access. Conventional underpricing and non-pricing leaves vast "space" for increase of charges.

Gas taxes and license fees are already in place and^d only want rate increases. Vehicle property taxes may be capped by Prop 13 but nothing prevents charges based on putative social cost factors like length, width, height, center-of-gravity, axles, wheelbase, length, turning radius, weight/power ratios, poor carburetion, or whatever else seems related to social cost.

Parking charges want graduating by neighborhood land rents. Now most violations occur in high-rent areas because fines are uniform. Charging moving vehicles for occupying valuable space is now technol^ogically feasible with bar-code scanners and other devices already in use on one Freeway in Dallas and scheduled for a few bridges in New York.

In addition, quite apart from traffic, the third dimension of streets and highways is everywhere grossly underdeveloped, both for transportation and other uses from luxury hotels down to hobo jungles. The luxury hotels could yield us heavy rents.

The conventional view is that merchants who provide free parking render a public service by keeping cars off the streets, but the invisible premise is underpricing of street use. Let street space be priced economically and private space ceases to deserve encouragement and might even be taxed as a penalty for making pedestrians walk farther between buildings.

Leasing State Lands

California has lost much revenue from its valuable tidelands oil by its "utility type" lease contracts which let lessees deduct almost any cost from net "income," and then pay a high share of same to the state landlord. A narrower construction of what is legitimately deductible would reduce deductions and raise lease revenues.

In many states of the Mississippi Valley there are too many "sweetheart leases" of public lands, the private lessees being so much more motivated than the guardians of the public weal. In Illinois and Mississippi the loss of Trust Lease Revenues from School Lands is notorious. The payoff will be high for those ^{who} in the press for fair deals.

Aircraft Landing Fees

The use of limited airspace around busy airports has in our times attained a very high scarcity value. Airspace is a natural resource, or "land" in the generic economic meaning. It is limited, it is in high demand, it can yield high rents, and it is clearly public domain. Alfred Kahn, James Nelson, Jeremy Warford and other students of airline economics have long urged tapping these rents, and shown how, too.

The federal Treasury is the logical beneficiary. But it has failed to preempt these revenues, and in the dereliction of Congress there is a vacuum for states and cities to fill. How? Retain a moderately creative attorney to

define landing time-slots as privileges under state law, then auction them to the highest bidders as Kahn and other^s urge. Failing this, at the very least they are easements over real property, and taxable as such.

This would have the added benefit of shortening or eliminating the growing queues of stacked-up aircraft, and is often urged for that reason alone.

Rights-of-way (ROWs)

Rails, gas, power, water, sewer, telephone, cable, and other networks use what are called lines, but these "lines" are anything but Euclidian. Some power ROWs are wider than highways; they also have third dimensions. They are often hard to cross, and may be used to block others' ROWs. They were acquired usually using eminent domain, giving land in this form a value that is a quantum higher than adjacent values. They give monopoly control over service territories, fortified by service franchises, and often effective political control over Commissions that supposedly regulate them.

This economic value and power represents high opportunities to tap rents for public purposes. Today, land can hardly be used without utility services. Utility rates and taxes may be structured so as to capture much of the economic rent from private land use and development. For a simple example, utility users are often required to pay a flat service or "demand" or hookup charge, in addition to variable charges based on use. The flat rates might be proportioned to estimated customer land rents.

Of course that is not "cost-justified^d" but the principle of price discrimination is deeply embedded in utility practice and regulatory policy anyway. Railway rates have long been dominated by "value-of-service" more than "cost-of-service." Economists of the most conservative hue have long touted price discrimination by utilities, to capture "consumer surplus" and permit of marginal-cost pricing for the "tail-block" rates. They have quite explicitly seen price discrimination as a preferred alternative to property taxation, to capture consumer surpluses.

Very well, then: use price discrimination to capture land rents. For in what do consumer surpluses lodge, if not the rent of lands served?

The revenue potentials are staggering. Consider telephone ROWs. Their value, already high enough to make AT&T the largest of all corporations, is taking off. There is exploding demand for computer services. A Digital Communications Network is upon us, using fiber-optics cables.

Rising demand, falling costs, monopoly control: what business could ask for more? This is the "Age of Communications." Most of the surpluses stand to be captured by those who control space on those telephone poles that crowd pedestrians off narrow sidewalks and carry wires in front of our favorite views. For one thing never changes, even as technologies come and go: those who control the resource base (the ROWs in this case) get the payoff.

When cable TV moved in, for example, how did they reach the public? They rented space on telephone poles.

So the public, to socialize rents, should do so in two steps. First, authorize utilities to discriminate, to use their monopoly power to extract maximum profits. Second, charge the utilities for their franchises, and their use of eminent domain, as a privilege, the charge being equal to the estimated monopoly profits.

Higher rates? In some cases yes, as where energy or water conservation is the social need. But the general idea is a high fixed demand charge where land is dear, followed by declining block rates such that the "tail-block" rate where marginal decisions are affected remains low.

There is a grave danger of collecting rents, only to dissipate them away in overexpanding utility systems into subeconomic territory. Indeed we already do so on a massive scale. To tap rents effectively for productive public purposes we must shake up the whole regulatory theory and system to avoid such waste. The details warrant a book or two; a start has been made elsewhere by the speaker. ("Land and Rent in Welfare Economics," in Clawson, Marion et al. (eds), Land Economics Research, Baltimore: Johns Hopkins Press, 1961.)

Radio Spectrum

Every week or so another radio or TV license changes hands at an advance over last week. As prices advance so, it seems, does concentration of control, with a few prominent media barons collecting ever larger chains. These prices do not advance mainly because of real investments in equipment, buildings or facilities, which often are inadequate and obsolescent. What rises is the natural resource base which is yielding more rent.

FCC rules which limit advertising time and mandate public service broadcasting have been pushed aside. These were ancient modes of asserting the public interest in a public domain resource, the radio spectrum. As the Feds release their dying grip might not states step in? Not "step," surely:

"shoot" is more like it. Still there is that resource, yielding high and growing rents ... Where there's a will there's a way.

Harvey Levin has written extensively on methods to measure and tap rents in radio spectrum. The techniques and understanding are there, no doubt of it.

States have been anything but shy about challenging federal sovereignty over minerals, waters and other public domain resources; or over rate regulation. There is no inherent reason for not doing the same with radio resources. "There's gold in them there commanding heights."

MODIFYING THE INCOME TAX

The income tax base includes income from land. For this we have to thank a few Georgist Congressmen of 1894 who got land included in the base of the income tax which Congress enacted then. In *Pollock v. Farmer's Loan and Trust Co.*, 157 U.S. 429 (1894), the Supreme Court threw out the whole law for that specific reason, leading to the 16th Amendment of 1913 which was necessary, basically, to let land income be included in the base.

Corporate income was successfully taxed from 1909, before the 16th Amendment, as an excise tax on the privilege of doing business as a corporation. "The excise tax used net income as a measure of the privilege of corporate business practice." [Bernard Herber, Modern Public Finance, p. 190]. The legalistic circumlocution suggests how creative lawyers can implement what Congress really wants. Someday another text might read, "The excise tax used land value as a measure of ^{the} privilege of holding title to natural resources."

But that may not even be necessary now. State legislatures, like Congress, have nearly complete control and discretion over what kinds of income to include or exclude from the income tax base. They have abandoned most of their discretion by piggybacking on Federal laws, but they have not abandoned all of it, and they could take it all back.

The income tax can be converted into a tax on land income in two steps. The first one is surpassingly simple: exempt wage and salary income from the tax, in whole or in part. One could also tiptoe up on this by raising the earned income exemption, the standard deduction, personal exemptions, etc. Workers paying the social security tax should be allowed to deduct it from taxable income. Raise the rates on what remains of the income tax base, which would now be mostly property income. If that seems shocking or radical,

recall that from 1913-41 (before withholding, and the explosion of the FICA deduction) most wage and salary income was in fact exempt. What is really shocking and radical is the massive shift of tax burden off property income onto wage and salary income, a shift that has perverted the whole notion of income taxation as originally adopted in 1913.

The second step is to remove capital income from the base. This is harder to understand, but easier to accomplish because it has already been done in part. Let me explain.

The present tax law includes several devices designed to lower ~~the~~^{or} effectively eliminate any tax on the income from capital. Basically, this is done by letting investors write off what they invest at or near the time they invest it. The investment tax credit (ITC) even goes farther and lets them write off more than they invest.

"Expensing" of certain capital investments means writing them off 100% in the year made. This privilege is so valuable it reduces the effective tax rate to zero, because after expensing the Treasury only receives a return on its own share of the investment. Accelerated depreciation is a substantial move in the same direction. Even straight-line depreciation is really accelerated compared to the true depreciation paths of durable capital, especially when coupled with the use of tax lives which are much shorter than economic lives of durable capital items.

None of those devices apply to land, however, because land is not depreciable. That is again thanks to generations of Georgists, starting with those in the progressive movement when the income tax was shaped. Who else would keep officials conscious that land is different? Standard-brand academic economists keep pushing the notion that land is just a form of capital.

To convert the tax fully to land, then, we need only complete step two by allowing universal expensing of all new investments. Voila!

At the same time we must plug many loopholes designed especially for land income. One of these is depreciating land, which is strictly illegal, but is often tolerated in practise when old buildings are depreciated from their purchase price by new buyers. I have published elsewhere a long list of other loopholes for land, and will not recite them all here. (Hearings on Economic Analysis and the Efficiency of Government, U.S. Congress, Joint Economic Committee, Subcommittee on Efficiency in Government, Part 2, pp. 405-15 1969. Also available from the author, %Department of Economics, UC Riverside, Riverside, CA 92521.)

Many will object, and with some reason, that the income tax only hits realized income from land, and exempts the holder who neglects or underutilizes land. True enough, but consider two points. First, we are surveying second choices after Prop 13 has foreclosed the best choice. Second, observe the behavior of private landlords and tenants. They often prefer arrangements that share risks and returns, like the income tax, instead of fixed cash rents that resemble the property tax. The cases are not perfectly analogous in all particulars, but suggestive.

In addition it seems clear that a legislature could define "land income" as ^afixed proportion of land value, regardless of use. Plenty of economists would come forth to testify that that is a reasonable definition.

MODIFYING THE SALES TAX

Another approach is to tax the consumption of land. Since land does not wear out with use, what does it mean to consume land? It can only mean to occupy a time-slot. And what does it mean to "occupy?" It can only mean to exclude others, i.e. to hold tenure. And what is the measure of what is thus consumed? The value of the land. The concepts may sound novel, but they are logically sound and, in my opinion, irrefutable.

There is great clamor now for increasing taxes on "consumption," allegedly to encourage capital formation. But in all the urgings I have never heard it mentioned that all sales taxes and VATs totally exempt the consumption of land. That gives a notion of the class bias in the movement for VAT. It is time to turn the tables and propose a tax on land-consumption. Such a tax would not in the least discourage capital formation, and can be shown on the contrary to stimulate both saving and investment.

The arguments might indeed be novel, but be of good cheer, they would be powerful enough to make waves, rattle cages and undermine pillars. Thus they would offer new career opportunities for rising scholars, and new ways to bedevil the older generation, something every new generation needs and relishes: is that not what makes the pendulum of history keep swinging?

TAXING NUISANCES

There is a strong Georgist case for taxing nuisances, on the grounds that they invade and claim de facto easements over common lands. Tobacco taxes

have long been levied on these grounds, and public approval grows stronger by the week.

Taxing air and water polluters by levying "effluent charges" won the favor of the economists dominant in the 1960's. The reasoning was pure Georgism: make them pay for preempting publicly owned air. Reaction later moved towards creating private property in pollution rights, but public outrage is now throwing back that notion, which only a Chicago economist could love.

Taxing pollution surrogates is also popular, especially to deal with non-point pollution that does not lend itself to effluent charges. The policy has its limits, but is part of any program to combat nonpoint pollution. (Cf. the speaker's "Nonpoint Pollution: Tractable Solutions to Intractable Problems," in Vladimir Novotny (ed.) Nonpoint Pollution, Milwaukee: Marquette University Press, 1988.)

Products that cause damage, anti-social behavior, and inflated demand for publicly-subsidized medical care may reasonably be taxed. Our most lucrative agricultural industry would provide high tax yields, should we ever decide to legalize it instead of trying vainly to suppress it.

Graffiti might be administratively difficult to tax, but what about billboards? These are merely legalized graffiti with social standing. Anyone who doubts the reality of visual pollution might shed all doubts by driving through Vermont, which outlaws billboards. The aesthetic and cultural differences are hard to miss. One could anticipate, too, that a society that penalizes billboards might have an easier time persuading the young to stop spraying graffiti.

Telephone wires, whose ROWs I have already recommended for taxation, could pay another tax as eyesores.

Noise pollution, as inescapable as smog, might well be taxed, if not prohibited. Especially taxable is deliberate, intrusive noise pollution, the kind that invades your privacy and degrades your environment, just to urge you to spend.

Once we start listing nuisances the list is as long as the run of Jimmy Hatlo's classic series, "They'll do it every time;" or the "Pet Peeves" column of the old Chicago Daily News. We must cap our peevishness with some rule of reason, yes; but here is a chance to fight back, raising revenues as we go.

PERMISSION TO IMPROVE LAND

Land has no value if it cannot be used; and its value depends on the kind of use allowed. Zoning, sewer hookups, building permits et al. have therefore become powerful tools of land use control. Such tools can be used in lieu of taxation to socialize rent.

That means they must not be given away. "Transferable development rights," TDRs, in which markets have developed, indicate the possibilities, but here the value of zoning was simply given away to private parties. It could instead be rented out to provide a source of continuing public revenue.

To make this a constructive tool, however, we must establish the principle that payment is required not just for using the TDR, but for having it. And having it is not entirely voluntary, that is zoning is granted not just to applicants, but to all landholders within certain areas. Payment should be based, that is, not on actual use but on economically feasible use, or highest and best use up to the allowable limit. Now we are approaching something with the same pro-incentive qualities as a land tax, but a different institutional basis.

At the city limits city services are worth big dollars to land speculators. A Riverside development firm, Thompson and Self, reported in a recent year donating \$55,000 to various campaigns. Soon there followed State legislation helpful for the annexation of their lands to our City. Surely it would be more useful for the City to collect that money directly, in annexation fees, and use it for socially constructive ends.

MORTGAGES

The property tax once included "intangibles," and in a few jurisdictions still does. Most jurisdictions have abandoned this tax because it is so easily evaded by hiding papers. That looks reasonable, but look again. One kind of paper is systematically recorded at the county level: mortgages, or deeds of trust. It is administratively feasible to put these into the property tax base, as Professor Don Hagman kept urging.

But is it desirable? A tax on mortgages would be fully shifted to borrowers in the form of higher interest rates, the supply of mortgage funds being highly elastic. Thus, to tax mortgages is indirectly to tax real estate.

Would holders of existing mortgages suffer? It must be conceded. But someone suffers with any change of tax or other public policy, there are always winners and losers. It is a risk all investors take knowingly. Phasing-in is also possible.

New lending would be discouraged? Yes, at the margins. The most sensitive margin is one which most people would not perceive at first, that is the margin of durability or longevity. The more deferred the benefit of an investment, the more interest-sensitive is its present value.

Finally, is that bad? We are all conditioned to answer "yes," but for myself I doubt it. More funds would be released for other kinds of loans, shorter-term loans, causing higher turnover both of loans, and the nation's capital stock. Both can be shown to have positive macro-economic effects.

Most beneficial would be the effect on stability of lending institutions. Just now we are looking at a \$50 billion bailout of S&Ls who got sick lending on real estate. Many commercial banks are deep in the same mire. It is time to revive the old "commercial loan" theories of banking, with their emphasis on liquidity and quality of credit, achieved mainly by sticking to self-liquidating short-term commercial loans, and avoiding long and speculative loans secured by real estate. It is a subject too big to open here, but you will find plenty of support in the history and theory of banking for keeping lenders out of mortgages.

It is widely assumed that cheap long term credit is essential to let most people buy real estate. Unfortunately that reasoning overlooks the nature of land values, which makes it circular. The main effect of long term loans has been to inflate land prices, creating the very problem it offsets. It is a treadmill effect, like keeping up with the Jones's.

Another benefit of including mortgages in the property tax base is to counter the argument that the property tax discriminates against equity holders of real estate. Many have questioned the equity of focusing taxes on the person with 5% equity in a parcel, while exempting his bank.

SUMMARY

There is more than one way to skin a cat, and to put rent to public uses. Prop 13, like all adversity, is a blessing in disguise because it makes us think.

Rent, wherever and however it turns up, constitutes a taxable surplus. And in the long run the only thing we can tax is a taxable surplus. There are just different ways of doing it. There is no cause to despair; we just need to be creative.

But we also need look harder at how government spends money. Prop 13 was not just a protest on a particular tax, but on wasteful spending, and on spending to benefit some few, rather than all. It was a protest against some government officials who act like masters rather than servants -- an arrogance which, in my own City, seems unabated by the "message of Prop 13."

But what makes officials so self-willed and pitted against the citizens is mainly the greed-frenzy of speculators who buy campaigns in order to reap unearned increments from extension of public works and services. So the very process of taxing rents and unearned increments is a major step to reign in public officials to serve the public. It is how we may turn "Negabucks into Megabucks" for real public services.

We have now surveyed several ways to tap rents after and in spite of Prop 13. These are:

- 1) Megabuck for Negabucks.
- 2) Price discrimination in utility services.
- 3) Reassess real estate held by corporations upon the sale of small amounts of stock. Likewise let any transfer, e.g. of partnership interest, trigger reassessment.
- 4) When new construction triggers new assessments, also reassess the land involved.
- 5) Remove all real estate except owner-occupied residences from the terms of Prop 13. The next step would logically be to remove all the value of said residences above, say, \$150,000 from said terms; to remove all but primary residences; and to remove all residences owned by aliens and/or non-residents.
- 6) Split the roll into several classes, with higher rates on those classes generally yielding more pure land rent. An excellent example of the last is the private parking lot.
- 7) Make extensive use of special districts that levy zone-of-benefit assessments, legally exempt from Prop 13.
- 8) Make use of developer fees and impost fees, remaining alert, however, to their dangers.
- 9) Put most exempt land back on the tax rolls.

10) Introduce a severance tax on minerals and water, modifying the tax along the more sophisticated lines of a net proceeds tax.

11) Raise the gasoline tax.

12) Raise the yield tax on timber, offsetting its ~~band~~ effects by letting reforestation cost be expensed immediately.

13) Raise charges for the use of streets and highways, graduating them by the amount and value of space preempted. Large, immaneuvorable, road-hogging vehicles deserve special attention, in proportion to the high costs they impose on others by preempting their ROW, as scientifically determined by qualified traffic engineers. Surcharges are in order for threatening vehicles which, in crashes, impose more damage on others.

14) Charge full rent for use of state and local lands leased to private parties, using the best leasing techniques.

15) Aircraft landing fees.

16) Require utilities to exercise full monopoly price discrimination to tap land rents, and to turn the extra profits over to ^{the} State treasury in return for the privilege^s of eminent domain and exclusive franchise which give them the monopoly.

17) Find legal means to tap the rents in the radio spectrum.

18) Modify the income tax to make it mainly a tax on land rent.

19) Modify the sales tax to make it a tax on "land-conⁿsumption."

20) Tax pollution, and other nuisances.

21) Require payments for permission to use and improve land.

22) Add mortgages to the property tax base.

There is a wide range of options for tapping rents after Prop 13. So be of good cheer, we merely have to rethink our cause -- what are we really trying to accomplish? "The old order changeth, yielding way to new, and God fills Himself in many ways, lest one good custom^{er} should corrupt the world." Let us hasten to adapt ourselves to modern times before they, too, give way to newer times.

Do I really want all the schemes recited here? Not all, not really. I would hope as we proceeded along these lines the world would come to its senses and see the virtues of a land tax in lieu of, say, utility price discrimination on the grand, bold scale conceived above. But you never know until you try: let's start.