There is an Enormous Bias in our Property Tax
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Paper Delivered at the Conference on Land, Wealth, and Poverty

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INTRODUCTION

THERE IS AN ENORMOUS BIAS IN OUR PROPERTY TAX

(Why we have no hope. No big ideas to believe in.)

Prof. Mason Gaffney

Our economic bias is against production and commerce. It inhibits economic activity and encourages holding wealth inert and stagnant.

To achieve economic growth and higher income for everybody, society must recognize the benefits of supporting government and revitalizing infrastructure via land and resource rents. The rules governing the property tax and taxation of land values must be changed.

Today, ours is a society at war with itself. Rich versus poor.

The central economic reality is that the technology has enriched the most powerful has actually hurt nearly 45 percent of Americans. How has this happened.

THE BIAS HAS MADE US UNEQUAL

The current trend toward greater economic inequality is an intensification of historic conditions. A greater understanding of our history could help us focus more precisely upon the underlying causes and solutions. Let's look at the facts.

"In 1828, the richest four percent of New Yorkers owned about 63 percent of all corporate and non-corporate wealth in New York City, and by 1845 the share had risen to about 81 percent.

In the small towns and rural areas of the East Coast, 10 percent of the population owned about 90 percent of the wealth."

"Wealth was more equitably distributed on the frontier. In 1860, the richest 10 percent owned about 40 percent of the wealth. By 1890 the richest 12 percent of households owned 76 percent and the 5 percent owned 50 percent." (Benjamin Schwartz, Senior Fellow at the World Policy Institute N.Y. Times O-Ed, 12/19/95.)

OUR ECONOMIC BIAS HAS DEEP ROOTS

Macroeconomics, the study of what makes economics work is in trouble. There is a fundamental error in our understanding. A destructive bias.

The concentration of land and resource's rent into the hands of a few is the cause of our trend toward greater economic equality and the inhibition of economic growth.

We must have no illusions that current reform proposals will alter economic inequalities. **Only by educating the American people to the ancient and modern issues of land tenure, taxing methods and spending priorities can we hope to fundamentally alter those inequalities.**

We must stir people with our great insights and grand social visions. Henry George, the turn-of-the-century American economist and social philosopher, had few peers when it came to stirring the people: "If you move men, to what shall you appeal? Not their pockets, but their patriotism; not selfishness, but sympathy. Self-interest is a mechanical force, but in loyalty to higher impulses men will given even life."

Drastic changes and new philosophies are moving through Congress. They scare some because they move others.

Abstract philosophies, living in intellectual undergrounds, build slowly until suddenly they take command. This is how change occurs. Superficially, it seems "sudden," but intellectually the way has been paved by years of Grand Visions and Big Plans.

Both the Democrats and Republicans are committed to a growth rate of 2.5 percent. They view a five to six percent unemployment rate as "normal." We must have a higher growth rate to create jobs and additional revenue to pay for government and rebuild infrastructure.

True reform must benefit the thriftiest and most productive members of society. It must allow them to produce wealth. And if we want economic and social justice, then we should recognize that only radical reforms can bring it about.

WE MUST FUNDAMENTALLY ALTER THE RULES

A Successful Process of Reform Must Include Five Vital Priorities

Priority #1: Safeguard the Property Tax

We must uphold and safeguard the property tax as the mainstay of state and local finance. **It is partly a tax on land value. It is the institutional basis for much of the Georgist reform. Its existence is the reason we can hope to achieve the goal of supporting government from land rent in a non-catastrophic or revolutionary manner, using existing laws, administrative apparati, and tenures.** Capping the property tax rate, as in California, defeats the intent of tax reform and common sense!

New Hampshire raises 64 percent of its state and local revenues from the property tax, double the U.S. mean of 32 percent. New Hampshire is called a "low-tax" state, but its

property tax is the highest in the nation, per capita, at $1,344. The U.S. mean is $644 pc, and it goes down of $174 in Alabama. Alabama raises only 12 percent of its state and local revenues from the property tax - a distinction it shares with New Mexico. Politicians whose priority is raising sales taxes for "property tax relief" might study the feeble economies of Alabama and New Mexico and ask if that is the model which they aspire to. Alabama's pc income ranks 41st in the U.S. New Mexico's is #49. Georgists must stop looking for miracles in Fairhope. At Alabama rates, the Fairhope plan is tokenism. Meantime, New Hampshire's marshy peneplains, barren granites, icy winters, and impassable White Mountains are producing the 7th highest pc income in the nation.

In New Hampshire, fortunately, Assemblyman Richard Noyes is working for Georgist reform. He is Chair of the legislative committee overseeing assessment quality; his priority is bringing land assessments up to market, and building assessments down. He does this by pushing for more frequent reassessment. Whatever he thus achieves in the Granite State is magnified by its high dependence on property tax.

There has been much ado about Hawaii's phased-in shift to a graded property tax plan. However, Hawaii raises only 16 percent of its state and local revenues from the property tax, so the rate is very low. You can focus the Hawaiian property tax on land values 100 percent, and still have an 84 percent counter-productive tax system. Studies would then show little visible result from the reform. Critics would say "Ho-hum, we told you so."

New York ranks near the middle in the ratio of property taxes to all state and local taxes, at 33 percent (the U.S. mean is 32 percent). That is not so much because New York's property taxes are low - they are actually above average - because other taxes are even higher. New York is not the best place to sow the seed of the 2-rate tax-plan. The harvest of any success will be sparser than it would be in New Hampshire, but lusher than it would be in Hawaii, Alabama or New Mexico.

How about Pennsylvania? Sad to relate, it ranks low in property taxes per capita, at $609, less than half the New Hampshire level. It ranks below the middle in the ratio of property taxes to all state and local taxes, at 29 percent. Property tax reform in Pennsylvania, therefore, is heavily diluted. Add to that the problem of overlapping local jurisdictions: when a city reforms its property tax, the county and school district go on as before. What changes is 1/3 of 28 percent, or 9 percent of the state an local tax complex. Trench warfare in this state is inchmeal.

What happens when a state radically slashes its property tax? Michiganders are saying that they must wait and see, but there is no need for that: California has 17 years of experience. To read Michigan's future, study California's recent past. Her is what happened since California passed proposition 13 in 1977, slashing property taxes.

The direct results have been to cut public services, raise other taxes, and lose credit rating. Our school support fell from #5 nationally to #40 in 1985; it is still falling. County road maintenance is down to where my county (Riverside) is repaving its roads at an annual rate of once every 130 years. Once is 20 years is recommended here and up north you generally need a higher frequency. You can't just build infrastructure and then stop paying for it - it's a

perpetual commitment. Thanks to urban scatter, a higher fraction of our population now depends on these county roads.

In 1978 we had a surplus in Sacramento. Since then we have raised business taxes, income taxes, sales taxes and gas taxes. But we are broke every June. Even as other states are in the black again, having recovered from recession. Our state rating is now last among the 50 states. One of our richest counties, Orange, has gone bankrupt; Los Angeles is on the brink, saving itself by closing emergency rooms and hospitals that serve as a last resort for the uninsured poor. We are ill prepared for Congress' current move to shift more functions back to the states.

The private sector fares no better. Raising income taxes, business taxes, and sales taxes is not the way to stimulate an economy; they drag on work and enterprise. Our income pc declined from #7 to #12 among the states by 1992. It fell further from 1992-94. California was one of the three states where median household income fell. Our unemployment rate is 9 percent, 50 percent higher than the national mean of 6 percent. Our poverty rate is 18 percent, compared to 14.5 nationally. That helps explain why the only government function that grows now is building and operating prisons. One of our few rebounding industries is cinema. Another thriving trade is the auctioning off of used machinery for export to the east.

In 1993, there was net outmigration (including international migration) from this the state that has symbolized American growth since time immemorial. It is unheard of. Four hundred twenty-six thousand people were lost, nearly 2 percent of the population. This is a watershed change. Imagine, of all the states, California, America's trend-setter, our El Dorado, The Golden State, our Horn of Plenty, the safety-valve for job-seekers and retirees and entrepreneurs from everywhere, losing population! "What are we doing wrong?"

Our fall of income pc is greater than appears from a purely monetary measure. Real pay (in contrast $) has fallen more because of the drastic rise in shelter prices. In San Francisco, shelter takes 50 percent of the median income, with many other cities, especially coastal ones, not far behind. It is unusual to find livable quarters for less than $600 per month. The median home price rose 163 percent during the 1980s to $258,000 (that is just the median - the mean is higher). These prices are part of the C.O.L. of all renters and new buyers, a part not fully incorporated in standard CPI measures.

Some cities are in desperate straits. In 1976 San Bernardino was chosen an "All-American City, A City on the Go." Go it did: today 40 percent of its people are on welfare!

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

It should give one pause. It is the expectable consequence of what the voters did. They rejected the concept of taxing inert wealth in favor of the alternative: taxing liquidity, cash flow, work, production and commerce. The predictable result has been to inhibit economic activity, and encourage holding wealth inert and stagnant. They turned property

from a functional concept into a sacred one; from a commission to be enterprising, hire people, produce goods, and pay taxes into a welfare entitlement.

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

David Shulaman tersely summarized the distributive effects of Prop. 13 as he left us to become Chief Equity Strategist for Salamon Brothers in Manhattan: "it breached the social compact." Alienation is the result, and the results of alienation are the Rodney King riots, arson and looting.[1] The Watts riots, you may object, preceded Prop. 13, and you are right. However, the Watts riots were part of a national epidemic. By 1967 there were riots with arson and looting in 70 or more American cities. The Rodney King riots were endemic to California, and they spread over a much wider area of Los Angeles than the Watts riots did. The looters and arsonists were not all black, and the targets were not all white, but mainly Korean-Americans who just happened to be there minding their stores.

Conventional wisdom now blames our California bust on the end of the Cold War. Surely that is a factor, but as a casual explanation, it is too pat, too easy and too convenient. It shifts the load onto impersonal historical forces - the Marxist world view. Let us see if it can survive analysis.

Compare today with 1945. Los Angeles' economy depended much more on The Hot War, 1940-1945, than it every did on The Cold War. Los Angeles' wartime boom had swelled its population as no other great city, 1940-45. After 1945 the U.S. pulled the plug on defense spending, more than today. Jane Jacobs, in *The Economy of Cities*, tells us what happened to military spending in Los Angeles after 1945. It lost 3/4 of its aircraft workers, and 80 percent of its shipbuilders. It lost its military and naval overseas supply and replacement businesses. Troops stopped funneling through. It got worse: petroleum and cinema and citrus, its traditional exports, all declined.

Pundits then forecast a regional collapse, but Los Angeles boomed instead. The wartime immigrants stayed. They formed creative, innovative small businesses in large numbers, giving L.A. its deserved reputation for having the most dynamic, flexible, adaptable industrial base in the nation. Besides exporting goods, L.A. also became more self-contained, providing itself with more of the goods it previously imported. How could this be? Angelenos had access to land, the basis of all supply and demand in any economy.

Between 1945-50, one-eighth of all new businesses started in the U.S. were established in L.A. They were small, creative, flexible, miscellaneous, and too varied and

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[1]The consistent leader in death rate from violet causes is New Mexico, with the lowest property tax in the nation.

dynamic to classify. No Linnaeus could sort them in static conventional boxes; they were the despair traditional economic geographers and base theorists who were at a loss to explain the region's thriving economy. The new Angelenos stayed and started producing everything for themselves, some things previously imported, and others never seen before.

Eastern firms established branch plants. Top eastern students came to California's great university system and stayed behind to take jobs and make careers here, then sent their children through California's excellent public schools. California became famous for supporting outstanding higher education, highways, water supplies, public health, public safety, and other public services, all without repelling business by taxation. There was a regional "El Dorado Effect" as demand and supply grew together. Growing local demand allowed for economies of scale serving local markets. Food and shelter were cheap and abundant. Land for business was accessible, providing a basis for the California self-contained phenomenon. A "continental tilt" developed in both interest rates and wage rates, drawing in eastern capital and labor. Why is that not continuing today?

The invisible, pervasive change is due to Proposition 13, which makes it possible to hold land at negligible tax cost. In 1945 land was taxed at 3 percent every year, building a fire under holdouts to turn their land to use. Today that same tax cost is well below 1 percent. Using Gwartney's Rule of Thumb (see below under #2, A, "Reassessing Land Frequently") it is about 1/8 of 1 percent: a rate of 1 percent applied to 1/8 of the true value.

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

What was different then? We had high property tax rates, but they were more focused on land than now, less on new buildings. Another obvious difference was the lower burdens of sales tax, business tax, and income tax. California was more hospitable to Georgist thinking than perhaps any other state, shown by its long run of Georgist political action in the prior thirty years. Most people today are totally ignnorant of this subject. It has been deleted from our history books. Here is a brief review.

Several states had "single-tax" movements and initiatives, 1910-14, but most of them petered out. In California they continued through 1924, and then popped up again in 1934-38. In 1934 the "EPIC" campaign of Upton Sinclair included a strong Georgist element - he proposed the establishment of new factories and farms on idle land. At the same time, Jackson Ralston was pursuing a pure land tax initiative, 1934-38.

Sinclair and Ralston lost. But the very existence of such political action in California, when the movement was torpid elsewhere, tells us a lot. It reveals a large matrix of supportive voters and workers, with effective leaders, to whom politicians (including elected County Assessors) would naturally respond by focusing on land assessments. Politicians survive by accommodating and absorbing dissident movements. Even while "losing," such

campaigns raise consciousness of the issue. Thus, in California, 1917, land value constituted 72 percent of the assessment roll for property taxation.

This remained the California norm for years. California was different. Even into the 1960s, Sacramento County elected an avowed single-tax Assessor, Irene Hickman; San Diego County harbored an active movement for raising land assessments. The Henry George Schools of San Francisco, San Diego, Los Angeles and Sacramento were the most active such schools in the country: four in one state, when most had none. State Senator Al Rodd, Chair of the Senate Finance Committee, held hearings and tried to push land tax legislation through his Committee in the 1960s and early 1970s. He assigned a staffer, Jack Massen, to spend a year working out the detailed effects on intergovernmental relations. Assemblyman Dr. William Filante, from a base of Georgist support in Marin County, picked up the torch too.

California displayed amazing prosperity and growth up to 1978. It had the resilience to shrug off the loss of war industries after 1945 and still grow "explosively" (as Jane Jacobs put it). After 1978 we suffered a string of reverses. The timing, along with a priori causative analysis, plus direct observations too numerous to review support an hypothesis that the reverses were aggravated by Prop. 13. Michigan, be warned: "This Could Happen to You."

Priority #2: Enforce Good Laws

A. Reassess Land Frequently

It is important to assess land for tax purposes often, especially on a rising market. (Landowners will see to it you do so on a falling market.) Land appreciates most years, while buildings depreciate physically every year. Lagging assessments therefore automatically overtax buildings relative to land.

New Hampshire Assemblyman Richard Noyes has circulated data on the effect of reassessment in NH. The land fraction of assessed value rises each time there is a reassessment. Keene, NH leads with frequent reassessments, a high fraction of land in the mix, and a strong track record attracting enterprise and jobs.

In California, where we used to have good assessment, we now have bad assessment legally mandated by Prop. 13. So long as land is unsold, and/or not newly improved, its assessment rise is capped at 2 percent a year, while market prices soar. Here is one example of the results. This year the Metro Water District of Southern California (MWD) condemned 410 acres for its new Domenigoni Reservoir to expand the system (to accommodate land speculators in the desert boonies). The jury hit them for $43 million, which works out to about $1.95 a square foot.

The question occurred to me, how does that square with the assessed value for property taxation? I asked Ted Gwartney, a professional appraiser with the Bank of America, to check the assessed value. It is about seven cents a square foot. The condemnation price, supposedly based on market value, is about 28 times the assessed value.

This is not the result of fractional assessment. In California we assess property at 100 percent when land changes ownership or there is a new building. Rather, this is the result of Prop. 13 and its prohibition of market reassessment until land sells.

I thought that was startling, but Mr. Gwartney's reaction was, "What else is new?" He, who works with such data every day, has a rule of thumb that market land value in California today is about eight times assessed value. That is important enough to repeat: **our assessed land values are routinely at 1/8 of true land value.** I wouldn't dare say that on my own authority, but Mr. Gwartney is here to confirm it. He is a veteran appraiser; for many years he was Director of Assessments for the entire Province of British Columbia.

Does this help you understand why California landowners are now so slow to adapt to new demands? In 1945 the assessors were building fires under landowners, so they sought new strategies to meet new circumstances. Today there remains a weak incentive to improve to improve property: tax collectors generally cost them money when they make improvements. Sit still, lie low, hire no one, hang on, produce nothing, and your holding costs are negligible.

A little of the old magic lingers. In October, 1995, a 225-acre parcel in Corona, the Chase Ranch, was sold to a builder, Coscan Davidson Homes, for building 967 units. The previous owners, "GGS," including a Japanese insurance firm, were "seeking a way out. They were behind in tax payments and GGS was **losing its staying power**, ..." quoth Stephen Doyle, spokesman for the buyer. It is that "staying power" that stifles land use and production. Coscan wants to build immediately. Even so, though, they plan to take five years to build out the project - if everything goes well. This is the new, post-Prop. 13 meaning of "immediately."

In spite of extreme underassessment, the assessed value of taxable land in California is 40 percent of the total real estate value. Imagine what it would be if assessed values were real values, "marked-to-market," as the law used to stipulate. It would be over 70 percent, as in 1917. "Staying power" would go down; land use, jobs and production would rise.

B. Use of the Building-Residual Method of Allocating Value.

It is equally important to use the "Building-Residual Method" of allocating value between land and buildings. This means you value the land first, as though it were vacant, based on highest and best use. You subtract this land value from the total value of land-cum-building as currently improved: the residual, if any, is building value.

Valuing one lot or parcel this way, you have information needed for valuing neighboring and other comparable parcels. Using a map with value contours, you can value a whole city this way with surprising ease and speed.

Using this method, I valued Milwaukee land in 1963 and 1967. The building-residual method nearly tripled the land values reported by the City Assessor, who was using the assessor's usual inconsistent mix of various other methods. How's that again? Did I say **tripled?** Yes, I really said "tripled." By his methods, buildings on the eye of demolition were carrying values higher than their sites; by the building-residual method these old buildings had no value at all, which of course is why they were being torn down. Besides depreciation and

technological obsolescence, many buildings suffered severe "locational obsolescence," owing to shifting demand patterns. The land was re-usable, and had as much or more value without the extant buildings.

Using the building-residual method requires no change in present laws. It is within the latitude of assessing officials, who, in turn, respond to public opinion. The conscientious citizens' move is to educate and bring pressure, just as the old single-tax campaigners like Jackson Ralston did. In the process of "losing" they won over half of what they sought, just by taking a stand and making the effort.

C. Federal Income Taxes

One of assessors' greatest problems today is the strong pressures from owners who want to allocate as much value as possible to buildings that they may depreciate for federal income tax purposes. Here is where we must study how **the parts form the big picture.** Here is where federal and local tax policies intersect. Some Georgists have neglected or misunderstood the income-tax treatment of land income. Let us see how this works.

Congress and the IRS let one depreciate buildings, but not land, for income tax. This important distinction harks back to when the income tax was new, and Georgist Congressmen like Warren Worth Bailey, from Johnstown, PA and Henry George Jr., from Brooklyn were instrumental in shaping it.

When a building is new, the depreciable value is limited to the cost of construction. The non-depreciable land is the bare land value before construction. So far, so good. Over time, however, building owners have converted this into a tax shelter scheme. Owner A, the builder, writes off the building in a few years, much less than its economic life, and sells it to B. "A" pays a tax on the excess of sales price over "basis." The basis is reduced by all depreciation taken, so any excess depreciation is "recaptured" upon sale. It is defined by Congress as a "capital gain," and given the corresponding package of tax preferences: deferral of tax, lower rate, step-up of basis at time of death, tax-free exchanges, etc.

Thus far, any tax preference goes to A, the builder, and may be seen as a well-considered building incentive. Watch, however, what happens next. "A" sells to B and B depreciates the building all over again, from his purchase price. To do so, B must allocate the new "basis" - i.e., his purchase price - between depreciable building and non-depreciable land.

How shall B allocate the new basis? Enter the local tax assessor. Here is where local assessment intersects with Federal income tax policy. The IRS does not try to assess land and buildings. Instead, IRS instructions tell taxpayers they may use locally assessed values to allocate basis between depreciable buildings and non-depreciable land. The IRS accepts this allocation as conclusive. As a result, local owners of income property press their assessors to allocate as much value as possible to buildings, and as little as possible to land. This does not affect their local taxes, but lowers their federal taxes. It lets them depreciate land.

Local revenues are not immediately affected. Local assessors have little reason not to accommodate their constituents, local landowners, to help them depreciate land for federal and state income tax purposes. They have little reason to use the correct "building-residual" method of allocating value, and a compelling reason to use the wrong method that understates land value. Thus they convert non-depreciable land value into depreciable building value. It is the modern version of "competitive underassessment." In the process, they also convert the local property tax from a land tax into a building tax.

After a while B sells to C, who in turn sells to D, so each building is depreciated many times. So is a large part of the land under it, tame after time, although it should not be depreciated at all. This is carried so far that real estate pays no federal or state income taxes at all.

The solution to this lies with the U.S. Congress. The need is to limit depreciation to once cycle only. It is a most urgent problem for both federal and local treasuries. We all have Congressmen. Write them and raise their consciousness. They are brokers who respond to public opinion. It is we who are derelict.

Priority #3. De-Balkanize Tax Enclaves

A. Rich and Poor

There are rich jurisdictions and poor. Professor Tideman's paper in this conference alludes to this matter in passing. Let us support his point with some numbers.

In California, you might think that farm counties like Tulare have a lot more taxable value pc than cities, but *au contraire*. Tulare County reports assessed values per capita of $38,100; the whole State averages $60,000 pc. Suburban Marin County weighs in with $95,400; urban Los Angeles County has $59,000; Orange County has $74,000.

You might also think that Tulare, being rural, has a lot higher fraction of land value in its mix, but again, not so. The Land Share of Real Estate Value (LSREV) in Tulare County is 28 percent, compared to a statewide mean of 40 percent, and 47 percent in Orange County.[2] Grazing and mining counties like Inyo have high values of LSREV, but they are a small share of the farm economy.[3] Major farm counties with intensive farms, like those of San Joaquin Valley, have low values of LSREV.

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[2]This datum, and others of like kind, refute the conventional belief that farm counties are heavy on land in the mix. On this last point, I must respectfully take issue with my good old friend Gene Wunderlich, whose paper at this conference suggests that farm counties have higher land fractions. I wonder if he has perhaps conflated building values with pure land values? My data, from California State Board of Equalization, show lower land fractions in real estate in the purely rural counties of the San Joaquin Valley.

[3]Inyo County, lightly peopled but heavily cattled, has $136,000 per capita, with very few human capita (and its cattle are exempt from the California property tax).

Within counties, disparities among cities and school districts are much greater. In Tulare County, one pathetic little povertyville, the City of Parlier, has just $10,000 of assessed value per capita. Here are some assessed values per capita from different California cities in the County of Los Angeles: Lynwood, $21,500; Beverly Hills, $294,000 (14 times Lynwood); City of Industry, $5,533,000 (257 times Lynwood).

This is why some critics call the property tax "regressive." It has given some plausibility to the otherwise bizarre claim that switching to a sales tax is less regressive than sticking with the property tax. Within each city a property tax is progressive, but when your data meld cities like poor little Parlier and Lynwood with Beverly Hills, you sometimes find poor people paying more of their income in property taxes than rich people, and getting less for it. Switching just the **local** property tax to land ex buildings will do little or nothing to correct such disparities, and therefore make little progress toward overall social justice, and the wide support that will evoke. There is, in fact, a natural cap on local property tax rates imposed by local particularism: the City Council of Beverly Hills will not raise taxes in Beverly Hills for the benefit of voters in Parlier.

To avoid such regressivity we must work out some formula for power equalization. The most straightforward formula is simply a statewide land tax. On this I must again applaud Dick Noyes in NH - not for what he says, but what he does. What he <u>says</u> is that the genius of NH is its local control of revenues; what he <u>does</u> is initiate bills for a statewide land tax.

There are many other tax enclaves and exemptions by which much property stays off the tax rolls. I have a long list, with about 35 items. Here I'll just focus on two: timber and oil.

B. Timber and Timberland

Standing timber is generally now exempt from property taxes, by law or custom. Land remains on the property tax rolls. This sounds like a Georgist idea; advocate Ellis Williams, a forest economist, has made the point. It is, however, just partial and discriminatory Georgism. The present system works as though you exempted half the buildings in a city from a tax and raised the rate on the others. Timber is exempt, but as soon as it is cut, milled, and hammered into buildings, it goes on the property tax rolls. The bias is apparent between capital in different forms.

Standing timber still yields some revenue when it is cut. The idea has been to substitute a "yield tax" for the property tax. In practice though, yield tax rates are much too low to be revenue-neutral. In California, for example, the yield tax rate is 2.9 percent. It is levied just once during the tree's life cycle of 60-100 years, at the end. Two and nine tenths percent levied once at the end of each 60 years, is obviously less that one percent levied every year, starting from year one. Values are low in the sapling years, but well above zero, and in the last few years before harvest, the stumpage is worth nearly as much as its harvest value. I have calculated that a yield tax of 25 percent or so (varying with the interest rate and the tree-life) is needed to have the same present value as a one percent property tax.

Here is the revenue result in one major California timber County, Mendocino. Its major property value is timber, but the County government and its subdivisions hardly get dried

beans from the yield tax on it: $3.9 million in 1993, compared to $45 million from all property. This is not because they are cutting timber slowly; actually they are depleting the inventory. Neither is it because other values are high. This County has no large cities. Most of its people live outside the cities, and its annual timber harvest is twice as high as the sum of all its other "agricultural" gross output (including fishing). The **net** cash flow from timber harvests is much more than twice as high as the net cash flow from other property, because stumpage value is added mainly by property (land and trees), while other farm products like grapes, fruits, and milk are more labor-using.

How about land under the timber? It is separately valued, and kept on the property tax rolls. However, it yields revenue of only $1.2 million: one-third of what the yield tax renders.

Why so little? They could raise the valuation of timber land to compensate for exempting the trees. In addition, "timberland" in some areas is sold for vacation homes and resorts. Assessors once began using those sales to justify higher valuations. They also observed smaller timberland owners paying higher unit prices than giant corporate owners, and up-valued parts of their vast spreads accordingly.

Timber owners had other ideas, however. Major owners like SP (520,000 acres of timber in California) took alarm and went to Sacramento for relief. They got their lands put in a "Timber Preserve Zone" (TPZ) wherein land is assessed only on its putative value for raising timber, regardless of market value, regardless of alternative uses, and regardless of non-timber income from land growing timber. These "compatible" (untaxed) uses include grazing, resorts, vacation homes, campsites, fishing, hunting, watershed protection, tourism, rifle ranges, rights-of-way, mining, log storage, landings, roads, logging camps, etc. There is also hemp for the drug trade: possibly the state's most valuable farm crop, but unrecorded.

TPZ is hardly known outside the timber counties, but it covers vastly more than the better-known "Williamson Act" which provides for preferential low assessment of farmland. In Mendocino County, TPZ land of medium grade ("Site III") is now tax assessed at $136/acre. This is about ten percent of its value for growing timber (disregarding compatible uses), and a lesser fraction of its value for higher-valued "incompatible" uses like retirement homes that require formal "conversion" (obtainable on demand) out of TPZ. This is how they keep the tax payments on TPZ land down to only $1.2 million.

Mendocino County, lying on the north coast, is redwood country. Redwood's value on the stump ("stumpage") this year is 53 cents per board foot (pbf) when mature. In Shasta County, timber stumpage is worth about half that, 28 cents pbf, and is heavily logged at that value - Shasta is our second biggest producer. If it is worth logging great volumes of Shasta timber to get 28 cents pbf, then there is a lot of surplus in Mendocino timber at 53 cents pbf. This surplus is what makes this land so valuable for growing timber. This surplus, unvexed by taxation, is what makes these lands so attractive to, and the play-things of corporate raiders, merger specialists, speculators, arbitrageurs, lawyers, and junk-bond salesman living thousands of miles away.

Redwood is a faster-growing species than most western timber (although much slower than Yellow Pine in the southeastern states). An acre of good (Site II) Mendocino land will yield a crop of 40,000 bf after 60 years of growth, worth about $20,000 on the stump at the

1995 prices. Discounting that to the present, using a real interest rate of five percent, means dividing it by about 16. Add ten percent for the present value of all harvests after 60 years, and you have very roughly $1,400/acre for the land value based purely on timber culture, considering no other values. Yet under TPZ its assessed tax value is $156, about 11 percent of its true value just for timber culture. This is accomplished by legislating the actual acre values (California Revenue and Tax Code, Section 434.5). The legislated formula mandates that "income-based" assessments be based on **past** prices, projected into the far future with no adjustments for inflation, but discounted at a high interest rate. It is clear for whose benefit this law was framed.

Meantime, urban demand is probing up north into southern Mendocino County from the Bay Area and Sonoma County, its southern neighbor. Mendocino has a long, scenic coastline with premium amenity values. A significant fraction of the TPZ land has a speculative value for resort, retirement, residential, urban and vacation uses, well above its timber value. None of this is reflected in tax assessments: TPZ protects against that, even though owners may convert out of TPZ at will. Land may be classed as TPZ regardless of past, present, or intended use.

The private area of Mendocino County is 1.9 million acres. Half of that is timberland, with 863,000 acres in TPZ. At an estimated $1.36/acre in taxes, this contributes $1.2 million to the County budget. The County gets $45 million from all property, of which the timberland fraction is 2.7 percent.

Add to that the yield tax of $3,9 million and you have timber and timberland together providing about $5 million of Mendocino County revenues. However, the County and its subdivisions (especially school districts) get over $100 million in intergovernmental subventions from Sacramento, paid by taxes on income, sales and businesses. By comparison, the $5 million from timber is a paltry share indeed to come from the most valuable resource in the County.

Timberland owners around the country have sold this bill of goods to legislators. In many states, less than half the private land is fully taxable, because of such laws. These are not all western or southern states, either, as one might surmise. In NH, for example, only 45 percent of the private land (and none of the Federal land) is fully taxable. The rest is sheltered by the State's "Current Use" tax law, their version of our TPZ law.

Advocates for these laws argue that land taxes, accumulating with interest over long growth periods, would eat up all the profit from growing timber. Let us see. Taxes of $1.56 per acre per year, accumulating over 60 years at a real interest rate of five percent, come to $552 per acre in constant 1995 dollars. At that time the timber stumpage will be worth about $20,000 at 1995 prices, or 36 times the accumulated future value of the land taxes. (In addition, the investment will have served to shield the owners from the eroding effects of inflation, a benefit assumed away by using constant dollars. On top of that, it is a good bet the real value of timber will have risen after 60 years of population growth.)

Thus, land taxes would have to be 36 times what they are now to consume the whole value of timber harvests. The fact is, present taxes are a negligible token. Timberland is effectively sheltered from the full weight (light as it is) of the one percent property tax imposed

on ordinary land. It pays, as we have seen, only about $1.2 million a year in Mendocino County.

The acre value of timberland is low compared with downtown values in San Francisco, where one little square **foot** in the hottest spot may fetch $2,000. That is $87 million per acre! However, there are very few such golden acres, compared to a million acres of timberland in Mendocino County, some 35 million acres in California, and 737 million acres in the U.S. That is 32 percent of the area of the 50 states. (The fraction of private and public land in forests is, by coincidence, the same: 32 percent.)

Owing to the success of timber people in spreading their gospel, almost all of their land is underassessed. Almost all state yield taxes, imposed in lieu of property taxes on standing timber, are too low to be revenue-neutral. Add to that, Congress since 1943 has made timber a "capital asset" for federal (and therefore state) income tax. Many costs of managing and carrying this capital asset are expensible - certainly interest and property taxes are. The net result is that timberland contributes very little to public revenues at any level.

Residents of timber counties are typically scattered and poorly organized. Timber companies are huge, rich, few and tightly organized. In Mendocino County, Georgia Pacific and Louisiana Pacific, absentee owners, together own the best 500,000 acres - 58 percent of the County's timberland - and Georgia-Pacific owns Louisiana-Pacific. They control state forestry schools, paying professors as consultants. They support research in forest economics at think tanks like Resources for the Future in Washington, which has never criticized their tax preferences but trained its big guns on public agencies, the Forest Service and the Bureau of Land Management. "The industry" controls tax laws in 50 states, and sloughs tax burdens onto others. It will continue to do so until other taxpayers in the timber counties wake up and organize to control state timber tax laws.

C. Offshore Oil

In 1946 President Harry S. Truman, with the stroke of a pen, added 50 percent to the area of the U.S. when he unilaterally extended our traditional three-mile limit out to 200 miles. The first three miles were soon given to the coastal states; California and Alaska both raise large lease and tax revenues from their lands under these coastal waters. The next 197 miles, however, is unorganized territory, outside the sovereignty and tax reach of any state, or subdivision thereof.

Most of our domestic oil and gas is now produced from the seabed under this water wilderness. The property is public domain under federal BLM administration, but firms bid for leaseholds there under a system that the majors seem to manipulate to their advantage. Even so, there are some Federal revenues from both lease payments and corporate taxes. State and local revenues, however, are nil.

Counties may, and often do assess and tax "possessory interests" in leaseholds on federal uplands that lie within state boundaries. They are helpless, however, to tax such property held offshore. The property values are huge, and so are the firms that own the leaseholds. Many firms own tens of millions of acres apiece, areas larger than whole states.

Offshore oil is our largest enclave protecting rent-bearing lands from property taxation, and any other form of state or local taxation.

Some form of national property tax is called for; or higher lease payments in lieu of taxes. Perhaps some income tax surcharge is the best way, or special federal tax on net proceeds. This paper cannot enter the thicket of what jurisdiction should have sovereignty to tax offshore leaseholds, nor how best to levy the tax. The point here is that no system of resource-based taxation is complete, philosophically or practically, that leaves this enclave untouched.

D. Tax All Natural Resources Uniformly and Comprehensively

Advances in the arts and sciences keep disclosing new values in old resources. Owing to institutional lag, these values can grow huge without finding their way onto the tax rolls. A thoughtless reaction is, "Bureaucrats want to tax everything!" The point is to tax all natural resources uniformly and comprehensively, to end the lowering taxes on incomes, productive business, and sales! Land taxation will not win wide support, nor will it deserve to, if it is perceived as a tax focusing on median homeowners, farmers, and merchants, while exempting oilmen, media tycoons, and timber barons.

In addition to newly awakened resources, many resources long known (like water) are held in odd tenures that have not been recognized as taxable property, although they should be. Any comprehensive move toward using resource rents for public revenue must include these varied resources and tenures. I have a list of 30 or so, too many treat here. To give a sampling, they include pollution easements over air and water; aircraft landing time-slots and gates; aquifers; benefits from covenants; access easements; power drops; concessions; fisheries; franchises; the gene pool; grazing licenses; minerals; orbits; soils; radio spectrum; rights-of-way; shipping lanes; standing to sue; strata titles; use of the streets; wildlife; wind; and zoning.

In tapping these many varieties of resources and tenures for public revenues, citizens and their representatives may have to set priorities. Two practical criteria rise to the top: go first for the big values, and go for the soft targets.

The biggest values are probably in energy, communications, water, rights-of-way, zoning and street use. Let's just look at what we are learning about communications. Knowledge and entertainment appear both at top and bottom on man's hierarchy of needs. People without even adequate shelter may be seen huddled around TV sets; people in war, or under totalitarian governments, risk their lives to hear smuggled broadcasts. People with higher incomes and security equip themselves with mobile telephones, and call around the world; they rush to get on the information highway. AT&T was the biggest non-financial corporation in the world before splitting up. Newspapers depend on their "wire" services: one of the first Great American Monopolies was Western Union and its news appendage, AP.

Recent FCC auctions have fetched billions of dollars for spectrum licenses, but this is like selling the badlands after giving away the beachfronts. The values of extant licenses given away ion the past, especially spectrum in top locations, are much higher. AT&T recently paid $112.5 billion for the McCaw Company's spectrum licenses, which are a

smattering of all that is out there. These licenses should be on the property tax rolls in the jurisdictions that they cover. The revenue possibilities are staggering.

How about soft targets? A soft target is any tenure recently created, in a filed that is easy to understand. Fisheries come to mind. In the last few years governments in Canada and the U.S. have limited allowable fish hauls by excluding new fishing boats and imposing quotas on the owners of old ones. This "imposition" amounts to a gift. Some quotas swiftly rose in value to over $1 million each, suddenly creating a class society where before there was equal opportunity. There is now a class of *nouveau*, instant millionaires and parlor fisherman who rent out their quotas to working fishermen.

Very likely it is wise to limit fish catches and avoid the "tragedy of the commons." It is also necessary to police the waters and keep out alien interlopers, a dicey business calling for the full power of a strong national government. It is not necessary, however, to give away the quotas so dearly policed. It is obvious to any objective observer that the quotas should be sold or (better) leased to the highest bidder. If the Feds insist on giving them away, states and localities should class them as taxable property subject to a high rate. The best time to levy appropriate charges is when quotas are new, and the injustice of the present dispensation is apparent to all.

Another soft target is the Manhattan taxi license, or "medallion." For some reason this has long been a favorite object lesson among economists, even as they shut their eyes to grosser sources of rent. It may be because cabbies are rude and visible and lower class, but whatever the reasons these writers have shown their consciousness of the rent aspect of medallions, and raised the consciousness of others.

The reason for pursuing soft targets is not for the money they may yield, but for principle. Once the principle is understood and established, wider applications should follow. In economic principle, fishing quotas and taxi medallions are just like conventional land titles: privileged control over limited natural resources. If it makes sense to socialize the rent from quotas and medallions, why not land titles too?

Priority #4. What Tax to Fight First?

We must set priorities on taxes to lower and eliminate. The Georgist objective is dual: to raise taxes on land, and to lower taxes on other bases. Many Georgists have the posture and mindset of reforming just "the property tax," in a vacuum, but this was never George's main point. There are other new or augmented taxes more damaging and noxious than the property tax falling on reproducible wealth: state taxes on retail sales; payroll taxes; income taxes falling on wages and salaries; excise taxes; etc.

Some Georgists have supporting wiping out taxes on "personal" (movable) property. If political success be the test, this movement has won massively (although silently) in state after state, and in all Canadian provinces. The result, though, is to do as much harm as good, for the exemption of capital is partial and discriminatory. "Real" (immovable) capital is still taxed, biasing the way investors allocate capital. Indeed, some "real" property is changed into "personal" property simply by unbolting it from the floor.

The result is also regressive, because personal property in most industries is more concentrated in ownership than real capital. In farming, for example, personal property includes cattle, stored grain, and farm machinery, but the owner's dwelling is real capital.

Other Georgists have diverted their efforts into wiping out the property tax on standing timber, replacing it with a nominal yield tax. Again, the result is partial and discriminatory, biasing investors to allocate more capital in the form of timber, and correspondingly less in other forms. As noted earlier, the present system works as though half the buildings in a city are exempted from a tax and the rate on the others raised.

Timber-exemption is highly regressive because the ownership of timber is much more concentrated than the ownership of homes of loggers and mill-workers and retirees in the timber counties. It would not be so bad if the land taxes on timber-growing sites were raised enough to compensate for exempting the growing stock. However, as we have shown, these site taxes are also held down to token levels. The net result is to turn timber and timberland owners into a huge public welfare case supported by a sophisticated brainwashing machinery paid by the discretionary income and wealth of the industry.

Most Georgist activists today devote most of their efforts to lowering the property tax rate on urban buildings. As we have seen, this effort is only effective in states that still rely heavily on the property tax. Even in such states, all the gains won so laboriously, trench-by-trench, in Pennsylvania can be lost overnight should the State Legislate or the electorate decide to cap property tax rates and meet the shortfall by raising consumer taxes and income taxes. This has occurred in California, and been credibly threatened in Pennsylvania.

However, this effort is potentially productive, even in states with low property tax rates, because it sets the stage for raising the rates. Once buildings are exempted, a polity can raise tax rates without driving away industry, capital, or talented people. Today, politicians like California's Governor Pete Wilson enhance their careers by starving schools and libraries and police in order to attract and retain employers by offering lower tax rates. Given a property tax on land ex buildings, we could support the public services without penalizing true industry.

To achieve that end, we must stifle sales and payroll and income taxes. They are the chief alternatives to property taxes. They are inherently counterproductive because they are contingent on some "taxable event" which is a constructive act of production or exchange. Henry George, in one of his striking similes, observes that a packhorse can carry a heavy load on its back, but hardly any load if you bind it to the shins. Economic theorists write of the "excess burden" of excise taxes, and the "Laffer Curve Effect;" lawyers write of "taxable events:" both are saying the same thing in their own argot. Sales and payroll and income taxes are like the load strapped to the packhorse's shins, dragging on every step. Indeed, they are more like a load bonded under each hoof: the horse has no burden if it just stands still.

What, then, makes these regressive taxes so attractive to landowners? Why this constant clamor and pressure to raise them to provide "property tax relief?" In the short run they do relieve landowners. They appear to shift taxes off landowners, who are well organized and vocal, and onto working people who are not. But they soon shift back onto landowners by repelling mobile capital and labor.

Priority #5: Make Landowners Pay Their Taxes

The solution is to **make the regressive taxes pinch landowners**. The income tax, when new, was designed to do exactly that. Georgists like Congressman Henry George, Jr. and Warren Worth Bailey took the lead in shaping it to do so. Over time, though, it has changed into mainly a payroll tax, and as it changed it became increasingly popular with landowners. It served their greed and became the clarion call of their constant clamor for "property tax relief."

In 1942 Congress excluded 50 percent of "capital" gains from taxable income, and broadened the definition of "capital" assets. As top-bracket rates on "ordinary" income rose above 50 percent, Congress capped capital gains rates at 25 percent. Meantime, wage-tax-withholding was sold as a wartime measure - "We must all do our duty." College professors were dutifully indoctrinating their students that the income tax is the perfect tax: fair, progressive, allocationally neutral, all at once.

Then income tax rates went wild, going as high as 92 percent on "ordinary" income (but capped at 25 percent for capital gains). Federal and state income taxes became the mainstay of public finance. Owners of income property soon learned to avoid almost all income taxes by claiming short tax lives by which fictitious inflated depreciation write-offs offset all their cash flow. One a property has exhausted its depreciation "basis," owner A sells the property to owner B, who depreciates it all over again, and so on through several rounds (cf. p. 10, above). The only "recapture" of this excess depreciation is when A sells to B for a capital gain; in effect, the rent of income property shows up as "capital gains." This tax burden is minimized by keeping rates low on capital gains.

Many who think of themselves as "Georgists" have shut their eyes to this important matter. Some simply declare a pox on all forms of income tax. Others even join the hue and cry for exempting capital gains, specifically and preferentially, from income tax. These positions are, I submit, foolish. So long as we have an income tax that treats land income kindlier and gentler than wage and salary and interest income, so long will we have perpetual clamor for "property tax relief" by shifting the burden to incomes, until not burden remains to shift - a condition we are approaching in half the states.

Landowners and their advocates are ahead of us, and will remain so until we wake up. They are already lobbying to replace or supplement income taxes with what they miscall "consumer" taxes: various excise taxes, allegedly "general" retail sales taxes, income taxes with expensing allowed for all capital outlays, cash flow taxes, *et hoc genus omne.*

These taxes are mislabelled because they are all exempt land-consumption from the base. Land-consumption is holding land without its earning any cash. A true, comprehensive consumer tax would include such land-consumption. At the same time it would exclude retail purchases of necessities used to form and maintain "human capital." It would, in short, look more like a land tax than the present retail sales tax. It is only by bending the meaning of words to a class-biased goal that the apologists of private rent-taking and land-hoarding have sold sales taxes and VATs as taxes on "consumption."

To turn back the drive for more consumer taxation, we must insist that the base include land-consumption. Then either the drive would accomplish a Georgist goal, or more likely, the rent taking, land hoarding apologists would turn tail.

We cannot accomplish those ends if we fight only for local property tax reform. We have to marshal our forces where they will do the most good.

In the late 18th century and most of the 19th, revenue to operate government came mainly from the sale of land.

Throughout history - and even today - wealth and privilege has been based upon ownership of land and monopoly. Economics, unchecked and in ignorance of the land and rent question, remains "the caveman's law, the law of the sharpest tooth, the angriest brow and the greediest maw."*

But we know there is a better way. The recognition that "territoriality" may be necessary as the law of survival for lower species is not borne out for mankind; for humanity there is a higher order. The human condition, the dignity of man and the aspiring benevolence that are made material by way of man's free association and the free exchange of labor and its handmaiden - capital.

Land rent is socially created, it is the fruit of the loins of unfettered labor and capital. Monopoly and privilege are the highwaymen who rob us of the means to end poverty, slums and depression. This is the promise of LVT. This is the big idea. The hope. Something to believe in - its time surely has come.

* Al Smith, Presidential Candidate